



Group Statements

Comprehensive Guide to
Consolidated Financial
Statements

Volume 2

18th Edition

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Group Statements – Volume 2

Eighteenth edition

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Preface

The purpose of this book is to set out the principles and conceptual issues of consolidated financial statements based on International Financial Reporting Standards (IFRSs). It focuses on the principles of control and consolidation techniques in preparing consolidated financial statements for a group of entities. Furthermore, the accounting treatment of an investor's interests in associates and joint arrangements is covered in Volume 2 of this work.

The *Group Statements* book focuses on providing detailed explanatory application examples of the following IFRSs:

- IAS 27 *Separate Financial Statements*;
- IFRS 3 *Business Combinations*;
- IFRS 10 *Consolidated Financial Statements*;
- IAS 28 *Investments in Associates and Joint Ventures*;
- IFRS 11 *Joint Arrangements*; and
- IFRS 12 *Disclosure of Interests in Other Entities* (by providing limited disclosure examples of some core aspects).

The text includes numerous illustrative and practical examples which expand on the principles and conceptual issues of the standards above and related aspects of other IFRSs. The approach of the book is to primarily make use of the analysis of owners' equity in a table format. Extensive use is also made of pro forma consolidation journal entries while illustrating the preparation of a group's consolidated financial statements. In addition, the worksheet approach is applied up to the end of chapter 4 and again in the newly added chapter 17 on more advanced intragroup transactions. The text makes use of commentary to explain important concepts. Disclosure requirements for the consolidated financial statements are also illustrated in the examples.

Some general Taxation issues are also addressed to the extent that current and deferred tax is applicable to certain accounting areas in the context of this book. However, the book focuses on group statements under IFRSs, not on the detailed discussion and illustration of tax matters. The book only deals with some general tax aspects and does not aim to deal with all tax-specific aspects in detail.

The dates used in the text are indicated, for example, as 20.23 (not 2023). These dates should be viewed as fictitious dates and not as actual dates (i.e. not as 2023).

The book is aimed at:

- undergraduate and postgraduate university students registered for financial accounting modules;
- members and students of professional bodies such as the South African Institute of Chartered Accountants (SAICA), the South African Institute of Professional Accountants (SAIPA), the Institute of Certified Professional Accountants (CPA), etc.; and
- practising accountants and preparers of consolidated financial statements.

LexisNexis Passplus is still included for Volume 1 of this work. PassPlus is an electronic assessment tool which allows students to continuously assess their own understanding of, and progress through the textbook. All PassPlus questions are automatically and immediately graded by the system, which allows students to receive their feedback instantly. PassPlus also affords lecturers the opportunity to use the system for continuous assessment purposes, without adding any additional marking to their own workload. The most beneficial way for students to use PassPlus is to work through each chapter in the textbook and then complete the accompanying questions to test their progress.

During the latter part of 2017, the SAICA finalised its “syllabus overload” review, and some aspects were excluded or moved to an “awareness level” for the sake of SAICA’s professional assessment (the Initial Test of Competence (ITC)). The major aspects thus affected relating to *Group Statements* were as follows:

- investment entities;
- some aspects relating to the identification of a business combination and the acquirer;
- pre-existing relationships and reacquired rights in a business combination;
- some aspects relating to determining control (such as delegated power, principal/agent consideration; control of specified assets);
- vertical groups (less detailed emphasis);
- subsidiaries classified as held for sale and subsidiaries acquired with a view to resale;
- share buy-backs and rights issues of subsidiaries leading to loss of control or step acquisition;
- joint operation accounting;
- parent recognising its investment in investees at fair value/under the equity method in its separate financial statements (the update of this work focused on the parent carrying the investment at cost);
- group reorganisations;
- changes in interests in associate (but still an associate); and
- associates held for sale.

This work was updated to still include a brief discussion of some of these aspects (where relevant), but without very detailed explanatory examples thereof. Volume 2 was mostly affected by these changes. This Edition retained these aspects with a brief discussion or illustration for the sake of other stakeholders using the book.

The major updates in this 18th Edition include the addition of a new chapter on more advanced intragroup transactions, such as transactions relating to non-financial assets revalued/remeasured to fair value, financial assets, leases, and share trusts within a group. Furthermore, the tax rate used to illustrate some tax effects relating to the group statements was amended to 27%. As announced in the 2022 Budget Speech, the corporate income tax rate will be reduced to 27% for years of assessment ending on or after 31 March 2023 (28% before that). The tax expense in some examples may not necessarily be equal to 27% of the accounting profit, as random numbers may have been used. However, the tax effects of the consolidation adjustments were made with the correct rate(s) in mind.

In 2022, SAICA revised the level at which some group aspects may be examined in its ITC. This mainly includes the following changes in ownership:

- an associate becomes a subsidiary;
- a subsidiary becomes an associate;
- loss of significant influence over an associate or loss of joint control over a joint venture; and
- rights issues and share buy-back by an investee.

These aspects are mainly covered in chapters 11, 13 and 14 of Volume 2. An example of these events/transactions were mostly retained for the sake of other stakeholders using this book. However, only one example (no longer multiple examples illustrating various changes in ownerships) on rights issues and share buy-back transactions by subsidiaries were retained in chapter 14.

Various smaller updates were made to the text where deemed necessary.

With the 18th Edition, we say goodbye to Prof Carol Binnekade and Prof Nerine Stegman as authors following their retirement. We thank them for their dedication and hard work in making this work possible. With this Edition, we welcome Mrs Karabo Sihiya as co-author and look forward to her contributions.

We trust that users of this publication will find it beneficial.

THE AUTHORS
November 2022

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Legend

P/L	=	Profit or loss section of the statement of profit or loss and other comprehensive income
SFP	=	Statement of financial position
SCI	=	Statement of profit or loss and other comprehensive income
SCE	=	Statement of changes in equity
OCI	=	Other comprehensive income section of the statement of profit or loss and other comprehensive income
NCI	=	Non-controlling interests

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IFRS 3

Business combinations

– Advanced aspects

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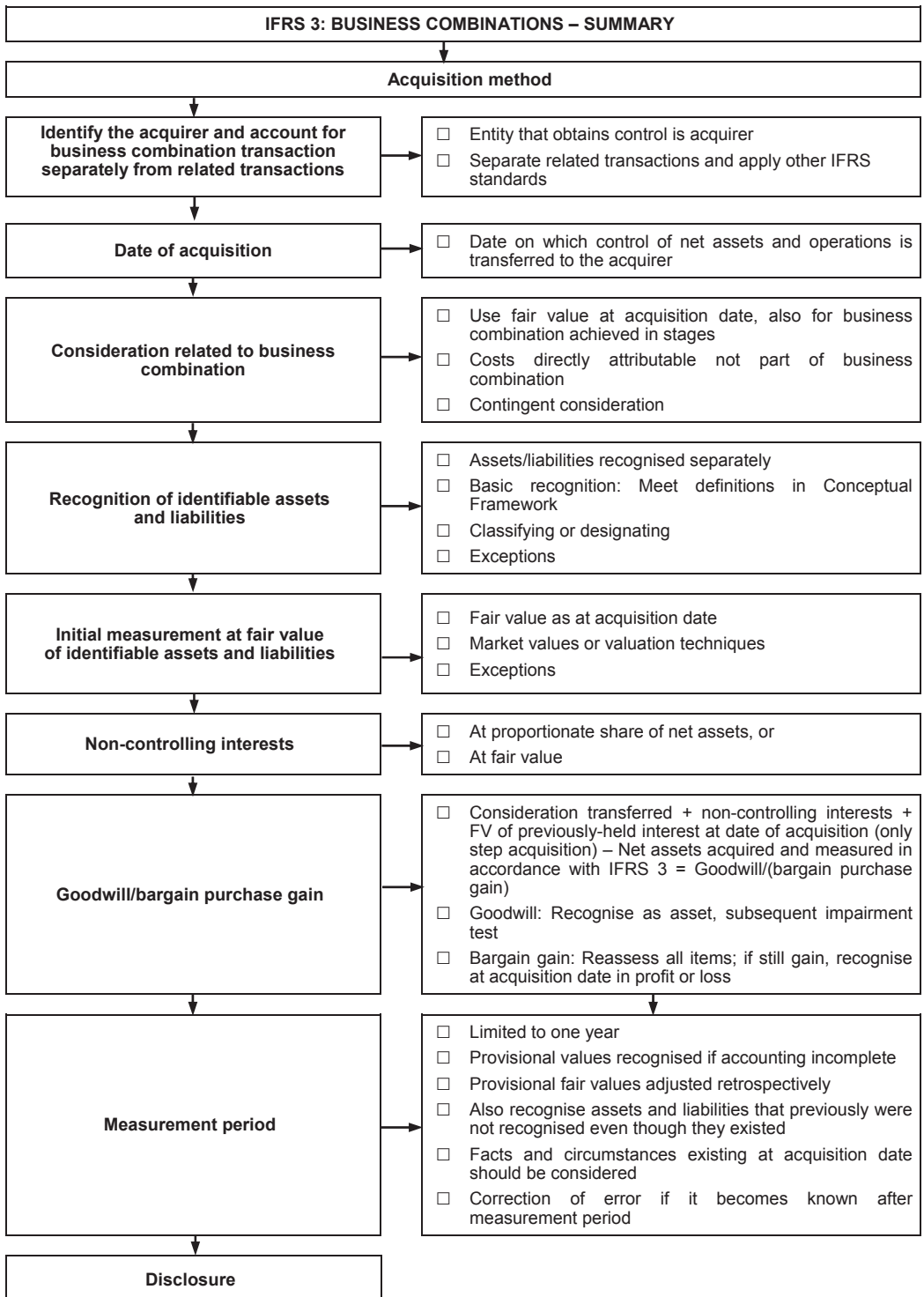
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Introduction

9.1 Overview of the topic

The basic principles and the disclosure requirements of **IFRS 3 Business Combinations** are discussed in **chapter 2 of Volume 1**.

IFRS 3 establishes very important principles on how the acquirer recognises and measures the following in its records:

- ☐ the assets acquired and liabilities assumed;
- ☐ the non-controlling interests in the acquiree;
- ☐ the goodwill acquired in a business combination or the gain from a bargain purchase; and
- ☐ adequate disclosure of information relating to the business combination, in order to provide useful information for decision making to the user of the financial statements.

In this chapter more advanced aspects are discussed relating to the recognition and measurement of the identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree, as well as the consideration transferred and measurement period. It is also important to remember that business combinations refer to the acquisition of a business (a subsidiary or the acquisition of assets and liabilities that constitute a business as defined in IFRS 3). This chapter focuses on the acquisition of a subsidiary. For guidance on the acquisition of assets and liabilities that constitute a business, refer to chapter 2 of Volume 1.



Comment

Also refer to chapter 8 of Volume 1 which addresses the accounting of a business combination achieved during instead of at the beginning of the financial reporting period.

The acquisition method

The acquisition method can be summarised as follows:

Step 1:

Identifying the acquirer (paragraph 2.4 of Volume 1)

Step 2:

Determining the acquisition date (paragraph 2.5 of Volume 1)

Step 3:

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree (paragraphs 9.2–9.4 of Volume 2)

Step 4:

Recognising and measuring goodwill or a gain from a bargain purchase (paragraph 2.7 of Volume 1)

In terms of the acquisition method, the goodwill or a gain from a bargain purchase is calculated as follows:



* Total net assets are equal to identifiable assets acquired less liabilities assumed.

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree

9.2 Recognition principle

IFRS 3 determines that the acquirer shall recognise, separately from goodwill, the **identifiable** assets acquired, the liabilities assumed and any non-controlling interests in the acquiree at the acquisition date.

1 Recognition conditions

Firstly, to be recognised, the identifiable assets and liabilities acquired and assumed must meet the definition of an asset or liability as defined in the **Conceptual Framework**. For this reason, future planned costs to be incurred by the acquirer will not meet the definition of a liability as at the date of acquisition, as there is no present obligation to incur these costs at this date. These costs will therefore only be recognised after the date of acquisition, when an obligation to pay arises.

Secondly, to be recognised, the identifiable assets and liabilities acquired and assumed must be part of what the acquirer and acquiree exchanged in the business combination transaction and not the result of separate transactions. Guidance is provided in IFRS 3 as to what forms part of a business combination transaction – this guidance is addressed in paragraph 2.10.

Thirdly, the acquirer's application of the recognition principle and conditions may result in some assets and liabilities being recognised in the business combination that the acquiree had previously not recognised as assets and liabilities in its pre-acquisition financial statements. This would be the case especially where the acquirer recognises, for example, certain intangible assets (e.g. brand names, customer relationships, etc.) at the acquisition date where these items were not recognised as intangible assets by the acquiree as they were internally generated by the acquiree. IFRS 3 has introduced some new principles, especially in respect of intangible assets in accordance with IAS 38. These are dealt with below.

Example 9.1**Recognition of identifiable liabilities**

On 1 April 20.28 P Ltd acquired 90% of the shares of S Ltd. From that date P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. On 1 April 20.28, S Ltd had correctly recognised a liability of R350 000 in respect of a breach of contract that was previously filed against the entity.

Furthermore, on 1 April 20.28 P Ltd was planning to restructure the operations of S Ltd. The restructuring costs were estimated at R240 000. Ignore any tax consequences.

As part of the business combination on 1 April 20.28, P Ltd shall recognise the identifiable liability for the breach of contract amounting to R350 000. However, on 1 April 20.28 there is no present obligation for the restructuring provision. The restructuring is rather a result of the business combination. P Ltd will only recognise the provision for the restructuring of R240 000 in the period **after** the business combination.

2 Classifying or designating identifiable assets acquired and liabilities assumed in a business combination

The acquirer shall classify or designate the identifiable assets at the acquisition date acquired and liabilities assumed to facilitate the subsequent application of other IFRSs. These designations or classifications shall be made on the basis of contractual terms, economic conditions, the acquirer's operating or accounting policies and other pertinent conditions as they exist at the **acquisition date**.

Two exceptions to this rule exist:

- ☐ the classification of a lease contract in which the acquiree is the lessor as either an operating lease or a finance lease in accordance with **IFRS 16 Leases**; and
- ☐ the classification of a contract as an insurance contract in accordance with **IFRS 4 Insurance Contracts**.

The above contracts will be classified on the basis of the contractual terms and other factors at the **inception of the contract** (or, if the terms of the contract have been modified in a manner that would change the classification of the contract, at the date of the modification, which may be the acquisition date).

Example 9.2**Classification of identifiable assets acquired**

On 1 January 20.29 P Ltd acquired a 75% interest in S Ltd. From that date P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. On this date S Ltd also had, amongst others, the following assets and contracts:

- ☐ From 1 January 20.29 S Ltd will be leasing a building to P Ltd. S Ltd classified the building as investment property as the building was held for rental income.
- ☐ On 1 January 20.23 (six years before the business combination) S Ltd (as lessor) entered into a lease agreement to lease equipment to X Ltd. The lease term was seven years and the economic life of the equipment was estimated to be eight years. S Ltd correctly classified the lease as a finance lease at the inception of the lease, as substantially all the risks and rewards incidental to ownership passed to S Ltd (this may be evident from the fact that the lease term (seven years) was for a major part of the economic life (eight years) of the asset ($7/8 = 88\%$)).

Ignore any tax consequences.

In accounting for the business combination of S Ltd, P Ltd may classify the above-mentioned assets and contract as follows:

- P Ltd will be occupying the building of S Ltd from the date of the business combination. Therefore, from the date of the business combination, the building will be owner-occupied. For the combined entity, the building shall be classified as property, plant and equipment in accordance with **IAS 16 Property, Plant and Equipment** instead of investment property. The **pro forma consolidation journal** entries will include the following:
 - reclassify the investment property to property, plant and equipment on acquisition date;
 - reverse any fair value adjustment that S Ltd recognised on the investment property from the date of acquisition;
 - elimination of any lease payments between P Ltd and S Ltd; and
 - recognise depreciation or revalue the building in terms of the group policy.
- The lease will still be classified as a finance lease (based on the contractual terms at the **inception** of the contract) even though the remaining lease term (one year) may not be a major part of the remaining economic life (which is two years). The lease contract will not give rise to any **pro forma consolidation journals**.



Comment

A **pro forma** journal entry is a journal entry that is **not** processed in the separate financial statements of the acquirer or the individual financial statements of the acquiree, but processed for the purposes of drawing up consolidated financial statements. Pro forma journal entries therefore only adjust the consolidated financial statements and are processed to give effect to IFRS 3 requirements and to eliminate intragroup transactions and balances in accordance with IFRS 10.

3 Guidance with respect to recognition of intangible assets

IAS 38 Intangible Assets provides extensive guidance about the acquisition of an intangible asset as part of a business combination (refer to IAS 38.33 to .43). The main principles are summarised below.

The fair value of an intangible asset at initial recognition is its **acquisition date fair value**. This fair value reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or amount of the inflow. Therefore, the probability-recognition criterion per IAS 38.21(a) is always considered to be satisfied for intangible assets in a business combination.

Intangible assets shall therefore be recognised separately from goodwill, if they are **identifiable**. IAS 38 defines the concept of identifiability, and these principles must therefore also be applied to the recognition of intangible assets at the acquisition date in a business combination.

In accordance with IAS 38, an intangible asset is **identifiable** if it meets either the **separability criterion** or the **contractual-legal** criterion. An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations.

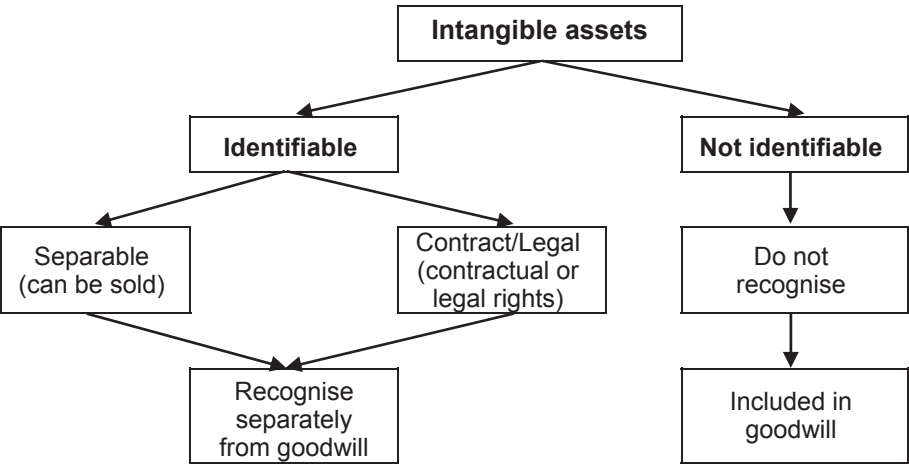
An intangible asset that is not individually separable from the acquiree or combined entity, and does not meet the contractual-legal criterion meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability.

The **separability criterion** means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licenced, rented or exchanged (individually or together with a related contract, identifiable asset or liability). An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them.

The **contractual-legal** criterion is met when the intangible asset arises from contractual or other legal rights.

The acquirer will subsume (absorb) into goodwill the value of all intangible assets that are not identifiable and all other assets that do not qualify as assets at the acquisition date. This is consistent with the principle in IAS 38.68(b).

The recognition of intangible assets in accordance with IFRS 3 can be summarised as follows:



The following intangible assets, that could be acquired in a business combination, are usually considered identifiable:

Identifiable intangible assets	
Separable	Contractual or other legal rights
Marketing-related intangible assets	
	☐ Trademarks, trade names, etc.
Customer-related intangible assets	
☐ Customer lists and non-contractual customer relationships	☐ Order or production backlog, customer contracts and related customer relationships
Identifiable intangible assets	
Separable	Contractual or other legal rights
Arts-related intangible assets (if protected by copyright)	
	☐ Plays, operas, etc. ☐ Books, magazines, newspapers and other literary works ☐ Musical works such as compositions, etc. ☐ Pictures and photographs ☐ Video and audio-visual material
Contract-based intangible assets	
	☐ Licencing, royalties, etc. ☐ Advertising, construction, etc. ☐ Lease agreements (whether the acquirer is the lessee or the lessor) ☐ Construction permits ☐ Franchise agreements ☐ Broadcast rights ☐ Service contracts ☐ Beneficial employee contracts (from the perspective of the employer) ☐ Use rights, for example water, air, etc.
Technology-based intangible assets	
☐ Unpatented technology ☐ Databases (if not protected by copyright) ☐ Trade secrets, such as secret formulas, processes and recipes (if not legally protected)	☐ Patented technology ☐ Databases (if protected by copyright) ☐ Trade secrets, such as secret formulas, processes and recipes (if legally protected) ☐ Computer software and mask works (if protected by patent or copyright)



Comment

Refer to IFRS 3.IE18–.IE44 for a detail discussion of the above-mentioned identifiable intangible assets.

Example 9.3

Recognition of intangible assets

On 1 January 20.29, P Ltd acquired a 90% interest in S Ltd for R550 000. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. On 1 January 20.29, S Ltd's recognised equity consisted of share capital and retained earnings amounting to R200 000 and R300 000 respectively. S Ltd also had, amongst others, the following assets:

	Carrying amount	Fair value
Licences and registered patent	R50 000	R62 000
Internally generated trademark	–	R34 000
Internally generated customer lists (subject to confidentiality agreements and cannot be sold)	–	R18 000
Assembled workforce	–	R13 000
Goodwill	R60 000	–
In-process research	–	R29 000

Ignore any tax consequences.

Recognition and measurement

The licences, patent and trademark are identifiable as they **arise from contractual or other legal rights** (IFRS 3.IE34, .IE39, and .IE18). These items are recognised as intangible assets at fair value (R62 000 and R34 000 respectively) as part of the business combination.

As the confidentiality agreements prohibit the disposal/exchange of information contained in the customer lists, the lists do not meet the **separability criterion** and are not recognised separately from goodwill (IFRS 3.B33). These intangible assets also do not arise from contractual/legal rights.

The assembled workforce does not meet the definition of an asset as it is not controlled (S Ltd does not have a contract with the collection of employees as a whole). The assembled workforce cannot be sold separately and does not meet the **separability criterion**. Therefore, the assembled workforce is not separately recognised as an intangible asset. The value placed on the assembled workforce is therefore subsumed into goodwill (IFRS 3.B37).

The goodwill of R60 000 arose due to a previous business combination. The goodwill is not an **identifiable intangible asset** as it is not separable nor contract/legal. The value placed on the goodwill is therefore also subsumed into the goodwill that will be accounted for by P Ltd.

The in-process research is **separately identifiable** as it can be sold separately and is therefore recognised as an intangible asset, separately from goodwill, at its fair value of R29 000.

The **pro forma consolidation journal** entries at the date of acquisition will be as follows:

		Dr R	Cr R
J1	Licences and patent (SFP) (62 000 – 50 000) Trademark (SFP) In-process research (SFP) Goodwill (of S Ltd) (SFP) Equity at acquisition (SCE) Pro forma remeasurement of intangible assets in terms of IFRS 3	12 000 34 000 29 000 	 60 000 15 000
J2	Equity at acquisition (SCE) Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) Non-controlling interests (SCE) ((15 000 + 200 000 + 300 000) × 10%) Elimination of investment against equity at acquisition	15 000 200 000 300 000 86 500 	 550 000 51 500



Comment

When remeasuring assets and liabilities of the acquiree to fair value on the acquisition date in terms of IFRS 3, the pro forma remeasurement can be recorded in any equity account of the acquiree. For ease of reference, the authors refer to “**equity at acquisition**”. The specific equity account used is not important, as at acquisition date the entire equity balance of the acquiree (including any remeasurements) will be eliminated in the main elimination journal, against the “investment in subsidiary” recorded in the separate accounting records of the acquirer.

Journal 1 and 2 could also have been combined in one single journal as follows:

	Dr R	Cr R
Licences and patent (SFP) (62 000 – 50 000) Trademark (SFP) Goodwill (of S Ltd) (SFP) In-process research (SFP) Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) Non-controlling interests (SCE) ((200 000 + 300 000 + 12 000 + 34 000 – 60 000 + 29 000) × 10%) Elimination of investment against equity at acquisition	12 000 34 000 29 000 200 000 300 000 86 500 	 60 000 550 000 51 500

Subsequent measurement

The accounting policy of the group is to amortise all intangible assets on the straight-line basis over their useful lives. On 1 January 20.29, the remaining useful life of the acquired intangible assets were as follows:

- ☐ licences and patent: two years;
- ☐ in-process research: one year; and
- ☐ trademark: five years.

S Ltd made a profit of R100 000 and R120 000 for the 20.29 and 20.30 financial year respectively. On 31 December 20.30 S Ltd impaired its goodwill of R60 000 relating to a previous business combination, to zero in its individual financial statements. The goodwill that arose with the business combination of S Ltd was not impaired.

The consolidation journals on **31 December 20.29** (reporting date) will be as follows:

		Dr R	Cr R
J1	Licences and patent (SFP) (62 000 – 50 000) Trademark (SFP) In-process research (SFP) Goodwill (of S Ltd) (SFP) Equity at acquisition (SCE) Pro forma remeasurement of intangible assets in terms of IFRS 3	12 000 34 000 29 000	60 000 15 000
J2	Equity at acquisition (SCE) Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) Non-controlling interests (SCE) ((15 000 + 200 000 + 300 000) × 10%) Elimination of investment against equity at acquisition	15 000 200 000 300 000 86 500	550 000 51 500
J3	Amortisation (P/L) (6 000 + 6 800 + 29 000) Accumulated amortisation: Licences and patent (SFP) Accumulated amortisation: Trademark (SFP) Accumulated amortisation: In-process research (SFP) Additional amortisation due to fair value adjustments at acquisition	41 800	6 000 6 800 29 000
J4	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of NCI's portion of the profit for the year ((100 000 – 41 800) × 10%)	5 820	5 820

Calculations

	S Ltd	Group	Difference
Licences and patent 1 January 20.29	50 000	62 000	12 000
Amortisation for the year	⁽¹⁾ (25 000)	⁽²⁾ (31 000)	(6 000)
Licences and patent 31 December 20.29	R25 000	R31 000	R6 000
Trademark 1 January 20.29	–	34 000	34 000
Amortisation for the year	–	⁽³⁾ (6 800)	(6 800)
Trademark 31 December 20.29	–	R27 200	R27 200
Goodwill 1 January 20.29	60 000	–	(60 000)
Amortisation for the year	–	–	–
Goodwill 31 December 20.29	R60 000	–	(R60 000)
In-process research 1 January 20.29	–	29 000	29 000
Amortisation for the year	–	(29 000)	(29 000)
Research 31 December 20.29	–	–	–

(1) $50\,000/2=25\,000$ (3) $34\,000/5=6\,800$ (2) $62\,000/2=31\,000$ **Comment**

The fair value adjustments made to the intangible assets will also have an effect in the periods following acquisition. The subsequent pro forma consolidation journals will include amortisation in accordance with IAS 38.

The consolidation journals on **31 December 20.30** (the following reporting date) will be as follows:

		Dr R	Cr R
J1	Licences and patent (SFP) (62 000 – 50 000) Trademark (SFP) In-process research (SFP) Goodwill (of S Ltd) (SFP) Equity at acquisition (SCE) Pro forma remeasurement of intangible assets in terms of IFRS 3	12 000 34 000 29 000	60 000 15 000
J2	Equity at acquisition (SCE) Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) Non-controlling interests (SCE) ((15 000 + 200 000 + 300 000) × 10%) Elimination of investment against equity at acquisition	15 000 200 000 300 000 86 500	550 000 51 500
J3	Retained earnings – Beginning of year (SCE) Non-controlling interests (SCE) Allocation of NCI's share of opening retained earnings	5 820	5 820
J4	Retained earnings – Beginning of year (SCE) Amortisation (P/L) (6 000 + 6 800) Accumulated amortisation: Licences and patent (SFP) Accumulated amortisation: Trademark (SFP) Accumulated amortisation: Research (SFP) Additional amortisation due to fair value adjustments at acquisition	41 800 12 800	12 000 13 600 29 000
J5	Accumulated impairment: Goodwill (SFP) Impairment (P/L) Reversal of impairment loss of S Ltd as already written off at acquisition in group	60 000	60 000
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of NCI's portion of the profit for the year ((120 000 – 12 800 + 60 000) × 10%)	16 720	16 720

Calculations

	S Ltd	Group	Difference
Licences and patent 1 January 20.30	25 000	31 000	6 000
Amortisation for the year	⁽¹⁾ (25 000)	⁽²⁾ (31 000)	(6 000)
Licences and patent 31 December 20.30	–	–	–
Trademark 1 January 20.30	–	27 200	27 200
Amortisation for the year	–	⁽³⁾ (6 800)	(6 800)
Trademark 31 December 20.30	–	R20 400	R20 400
Goodwill 1 January 20.30	60 000	–	(60 000)
Impairment for the year	(60 000)	–	60 000
Goodwill 31 December 20.30	–	–	–
In-process research 1 January 20.30	–	–	–
Amortisation for the year	–	–	–
Research 31 December 20.30	–	–	–

(1) $50\,000/2=25\,000$ (2) $62\,000/2=31\,000$ (3) $34\,000/5=6\,800$ **Research and development expenditure**

It was indicated above that it is possible for an acquirer to recognise some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its pre-acquisition financial statements. The **in-process research** in the example above is an illustration thereof. Furthermore, IAS 38 provides specific guidance on the treatment of research and development expenditure. Research or development expenditure that:

- ☐ relates to an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset; and
- ☐ is incurred after the acquisition of that project;

shall be recognised as an expense when incurred if it is research expenditure or development expenditure that does not satisfy the criteria for recognition as an intangible asset, and included in the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the criteria for recognition as an intangible asset per IAS 38.57.

9.3 Measurement principle

The acquirer shall measure the identifiable assets acquired and liabilities assumed at their **acquisition date fair values**. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. acquisition date.

Example 9.4	Remeasurement of liability to fair value
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On 1 January 20.27, P Ltd acquired a 100% controlling interest in S Ltd. On acquisition date, S Ltd's liabilities included 10 000 7% debentures of R100 each, issued on 1 January 20.26 to Z Ltd. The debentures are redeemable at nominal value on 31 December 20.30 and interest is payable annually in arrears. On 1 January 20.26 the applicable discount rate was 10% and on 1 January 20.27 the applicable discount rate reduced to 9%. Ignore any tax consequences.

On 1 January 20.27 the assets acquired and liabilities assumed of S Ltd should be measured at fair value.

S Ltd already accounted for the debentures in its individual accounting records according to IFRS 9. Therefore, the pro forma consolidation journal entries will account for the difference between the carrying amount of the debentures in S Ltd's individual financial statements and the fair value as calculated in accordance with IFRS 3.

	S Ltd	Group	Difference
Fair value 1 January 20.26	⁽¹⁾ 886 276		
Finance costs	⁽²⁾ 88 628		
Debenture payment	(70 000)		
Amortised cost 31 December 20.26	R904 904		
Carrying amount/Fair value 1 January 20.27	904 904	⁽³⁾ 935 206	30 302
Finance costs	⁽⁵⁾ 90 490	⁽⁴⁾ 84 169	(6 321)
Debenture payment	(70 000)	(70 000)	–
Amortised cost 31 December 20.27	R925 394	R949 375	R23 981

(1) Pmt = 70 000; i = 10%; n = 5; FV = 1 000 000

(2) $886\,276 \times 10\%$

(3) Pmt = 70 000; i = 9%; n = 4; FV = 1 000 000

(4) $935\,206 \times 9\%$

(5) $904\,904 \times 10\%$

The **pro forma consolidation journal** entry at the date of acquisition will be as follows:

		Dr R	Cr R
J1	1 January 20.27 Equity at acquisition (SCE) Debenture liability (SFP) Remeasurement of debentures	30 302	30 302

The following consolidation journal entry will be required at the reporting date (31 December 20.27):

		Dr R	Cr R
J2	Debentures (SFP) Finance costs (P/L) Adjustment of finance costs for 20.27	6 321	6 321

**Comment**

Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in profit or loss after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

The carrying amount of the liability that is brought into the consolidation at the reporting date (when the consolidation procedures commence with combining each line item of S Ltd to those of P Ltd – see IFRS 10.B88(a)) amounts to R925 394. The **pro forma journals** adjust the line item as follows:

$R925\,394(\text{S Ltd}) + R30\,302(\text{J1}) - R6\,321(\text{J2}) = R949\,375$ (as it should be for the group, based on the fair value at the acquisition date).

1 Guidance with respect to measurement of assets with uncertain cash flows

The effects of uncertainties about future cash flows should be reflected in the acquisition date fair value of assets and liabilities, on the acquisition date. All acquired assets and assumed liabilities are measured on acquisition date at fair values, and thus shall not be subject to a separate valuation allowance in respect of cash flows that are deemed uncollectible at the acquisition date. For example, the fair value of receivables acquired as part of a business combination will be determined based on the expected cash flows, timing thereof and the appropriate discount rate. A separate valuation allowance (allowance for credit losses) will not be recognised because **the discount rate already accounts for any uncertainties**.

2 Guidance with respect to measurement of assets subject to operating leases in which the acquiree is a lessor

The acquisition date fair value of an asset, which is subject to an operating lease in which the acquiree is a lessor, should take into account the terms of the operating lease. This means that the lessor shall not recognise a **separate** asset or liability if the terms of the operating lease in which the acquiree is the lessor are either favourable or unfavourable when compared to market terms.

Example 9.5

Fair value of operating lease – Lessor

P Ltd acquires a 100% interest in S Ltd on 1 January 20.25. From that date P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. S Ltd owns a plant (as property, plant and equipment carried under the cost model), with a carrying amount of R3 750 000, that is leased to Z Ltd in terms of an operating lease, a an annual rental of R550 000 (a market-related rental is R450 000 per annum). The remaining period of the lease is 10 years, while the remaining useful life of the plant is 25 years.

The estimated fair value of the plant, based on a market-related rental for 25 years, is equal to R5 million. Assume that the present value of the favourable component of the lease contract with Z Ltd amounts to R560 000.

Ignore any tax consequences.

When accounting for the business combination, the plant should be recognised at its total fair value of R5 560 000 (R5 000 000 + R560 000).

This will give rise to the following **pro forma consolidation journal entry**:

		Dr R	Cr R
J1	1 January 20.25 Plant (SFP) Equity at acquisition (SCE) Remeasurement of plant to fair value (5 560 000 – 3 750 000)	1 810 000	1 810 000

For group purposes, the subsequent depreciation of the plant should be based on R5 560 000. As the favourable component of R560 000 of the plant will realise over the remaining lease period of 10 years (refer to IAS 16.44), it would be appropriate to depreciate this component over 10 years, while the remainder of the asset should be depreciated over 25 years. The group's annual depreciation will therefore amount to R256 000 $[(5\,000\,000/25) + (560\,000/10)]$ from a group perspective. In its individual financial statements S Ltd will account for depreciation of R150 000 $(3\,750\,000/25)$.

On **31 December 20.25** (reporting date) the following consolidation journal is required:

		Dr R	Cr R
J1	31 December 20.25 Depreciation (P/L) Accumulated depreciation (SFP) Additional depreciation for 20.25 (256 000 – 150 000)	106 000	106 000

3 Guidance with respect to measurement of assets that the acquirer intends not to use or use in a way that is different from the way other market participants would use them

To protect its competitive position, or for other reasons, the acquirer may intend not to use an acquired non-financial asset, or it may not intend to use the asset according to its highest and best use. However, the acquirer shall measure the fair value of the non-financial asset assuming its **highest and best use** by market participants in accordance with the appropriate valuation technique in accordance with **IFRS 13 Fair Value Measurement**.

Example 9.6**Fair value of items used differently**

P Ltd acquires a 100% interest in S Ltd and has control over S Ltd as per the definition of control in accordance with IFRS 10. S Ltd owns export licences to export goods globally. At date of acquisition, the fair value of the global export licences is determined to be R900 000 and the carrying value R500 000 in S Ltd's accounting records. However, P Ltd intends to export only to Africa and determines the fair value of the licence to export to Africa only at R390 000. The carrying amount of the export licence is R500 000 in S Ltd. Ignore any tax consequences.

At the acquisition date, S Ltd also had an in-process research project with a fair value of R140 000. S Ltd has expensed all amounts incurred on the research in line with the requirements of IAS 36. P Ltd does not intend to continue with the research.

P Ltd does not intend to use the export licence or in-process research according to its highest and best use. Nevertheless, for the business combination, the export licences will be measured at R900 000 and the in-process research project at R140 000. The group may need to consider whether an impairment loss should be recognised in the period after the business combination (based on the recoverable amounts of the assets).

The **pro forma consolidation journal** entry at the date of acquisition will be as follows:

		Dr R	Cr R
J1	Export licence (SFP) (900 000 – 500 000) In-process research (SFP) (140 000 – 0) Equity at acquisition (SCE) Remeasurement of identifiable intangible assets to fair value at acquisition	400 000 140 000	540 000

4 Guidance with respect to measurement of intangible assets

If an asset acquired in a business combination is separable or arises from contractual or other legal rights (i.e. is identifiable as discussed above), sufficient information exists to reliably measure the fair value of the asset. Thus, the reliable-measurement criterion per IAS 38.21(b) is always considered to be satisfied for intangible assets acquired in a business combination. It is therefore clear that the emphasis lies on the satisfaction of the **definition of an intangible asset** (incorporating identifiability), rather than on the recognition criteria, as the latter are considered to be satisfied in a business combination as explained.

The fair value of an intangible asset would be the price that would be received to sell an asset in an orderly transaction between market participants at the acquisition date. Quoted market prices provide the most reliable estimate of the fair value of an intangible asset. If such market prices are not available, the price of the most recent similar transaction may provide a basis from which to measure the fair value of the intangible asset, provided no significant changes have occurred from the date of the most recent similar transaction to the acquisition date.

If no active market exists for an intangible asset, valuation techniques may be used to determine the fair value of intangible assets.

5 Guidance with respect to measurement of non-controlling interests

The **non-controlling interests**, if any, shall be measured by the acquirer in one of two ways, i.e. either:

- ☐ at fair value; or
- ☐ at the non-controlling interests' proportionate share of the acquiree's identifiable net assets (i.e. not taking into account the fair value of the non-controlling interests but basing the non-controlling interests on the net asset value of the entity instead).

The measurement choice is only available for **present ownership interests** (e.g. ordinary shares) which entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. All other components of non-controlling interests must be measured at fair value. If non-controlling interests include **preference shares** the preference shares shall be measured at fair value unless the preference shareholders are entitled to a proportionate share of the entity's net assets in the event of liquidation. The choice between the two methods of measuring non-controlling interests is not part of the accounting policy of the acquirer and **can be exercised for each separate business combination**.

If the acquirer measures non-controlling interests at fair value at the acquisition date, this value can sometimes be based on the market prices for the equity shares not held by the acquirer. Where market prices are not available for these equity shares, the fair value shall be determined by the acquirer using other valuation techniques. It is very possible that the fair value of the acquirer's interest in the acquiree and the fair value of the non-controlling interests in the acquiree on a per-share basis will differ due to the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree, or a discount, for the lack of control, included in the per-share fair value of the non-controlling interests in the acquiree.

The amount assigned to the non-controlling interests is included in the calculation of **goodwill or the gain from a bargain purchase** arising from the business combination. The acquirer's choice of the measurement basis of non-controlling interests for ordinary shares will therefore influence the resultant goodwill or the gain from a bargain purchase.

Example 9.7

Measurement of non-controlling interests

The equity of S Ltd consists of 100 000 ordinary shares (issued at R1 each) and 10 000 preference shares (issued at R11 each). The preference shares give their holders the right to a preferential dividend before the payment of any dividend to the ordinary shareholders. On liquidation of S Ltd, the preference shareholders are only entitled to receive their initial investment back before the remainder of the net assets are distributed to the ordinary shareholders. The preference shareholders do not have any further rights on liquidation. On 1 January 20.29 the ordinary and preference shares were trading at R34 and R15 each respectively. On 1 January 20.29 P Ltd acquired a 60% interest in the ordinary shares of S Ltd at a cost of R2,2 million. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. P Ltd did not acquire any of the preference shares of S Ltd. P Ltd was willing to pay more than R34 per share in order to gain control ($60\,000 \text{ shares} \times R34 = R2,04 \text{ million}$). The fair value of the identifiable net assets of S Ltd amounts to R3,3 million at the acquisition date (represented by ordinary share capital of R100 000, preference share capital of R110 000 and retained earnings of R3 090 000).

P Ltd can **elect** to measure the 40% present ownership interest (the ordinary shares) at its fair value. However, the non-controlling interests in the preferences shares should be measured at the fair value. Non-controlling interests will then amount to R1,51 million (40 000 ordinary shares × R34 plus 10 000 preference shares × R15).

The **pro forma consolidation journal entries** at the date of acquisition will be as follows:

		Dr R	Cr R
J1	Share capital: ordinary shares (SCE) Retained earnings (SCE) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) Non-controlling interests: ordinary shares (SCE) (40 000 × 34) Elimination of investment against equity at acquisition	100 000 3 090 000 370 000	2 200 000 1 360 000
J2	Share capital: preference shares (SCE) Goodwill (SFP) (balancing) Non-controlling interests: preferences shares (SCE) (10 000 × 15) Elimination of preference share equity at acquisition	110 000 40 000	150 000

OR,

P Ltd can **elect** to measure the 40% present ownership interest at its share of S Ltd's identifiable net assets. However, the non-controlling interests in the preferences shares should be measured at the fair value. Non-controlling interests will then amount to R1,47 million (40% × R3 190 000 (R100 000 share capital + R3 090 000 retained earnings) plus 10 000 preference shares × R15).

The **pro forma consolidation journal entries** at the date of acquisition will be as follows:

		Dr R	Cr R
J1	Share capital: ordinary shares (SCE) Retained earnings (SCE) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) Non-controlling interests: ordinary shares (SCE) ((100 000 + 3 090 000) × 40%) Elimination of investment against equity at acquisition	100 000 3 090 000 286 000	2 200 000 1 276 000
J2	Share capital: preference shares (SCE) Goodwill (SFP) (balancing) Non-controlling interests: preferences shares (SCE) (10 000 × 15) Elimination of preference share equity at acquisition	110 000 40 000	150 000

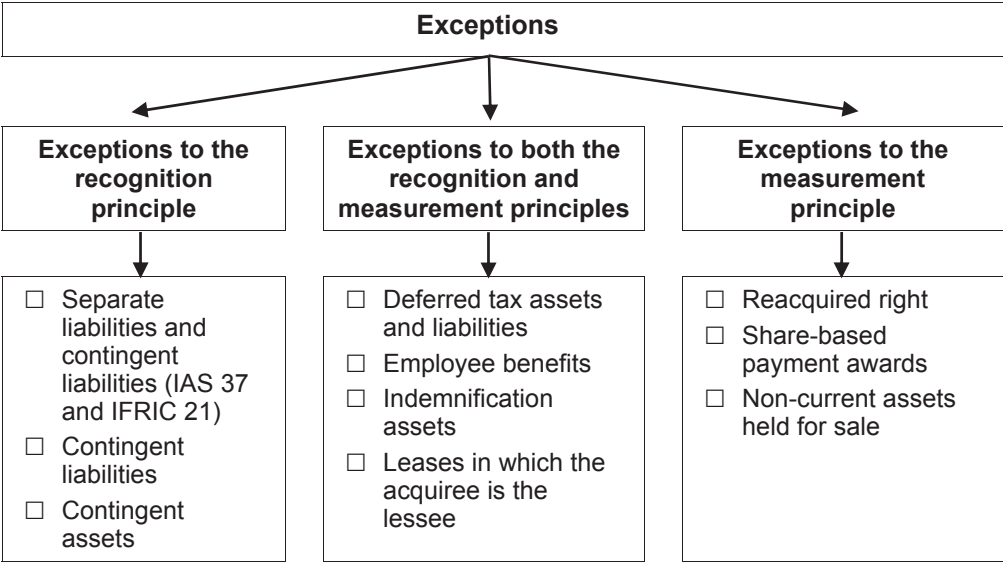


Comment

As the preference shares of S Ltd do not qualify as a **present ownership interest**, P Ltd does not have a measurement choice. The preference shares must be measured at fair value in terms of IFRS 3.

9.4 Exceptions to the recognition and measurement principles

As discussed previously, all identifiable assets acquired and liabilities assumed must be **recognised** if they meet the definition of assets and liabilities in the **Conceptual Framework**. The assets and liabilities recognised must then be **measured** at their acquisition date **fair values**. However, IFRS 3 provides the following exceptions to the recognition and measurement principles:



1 Exceptions to the recognition principle

Liabilities and contingent liabilities within the scope of IAS 37 or IFRIC 21

Liabilities and contingent liabilities that were incurred **separately** rather than assumed in a business combination shall apply IAS 37.15–22 or IFRIC 21 to determine whether a present obligation exists at the acquisition date. If a present obligation exists, as a result of a past event, the guidance below on **contingent liabilities and contingent assets** should be followed.

Contingent liabilities and contingent assets

A **contingent liability** is defined in accordance with **IAS 37 Provisions, Contingent Liabilities and Contingent Assets** as:

- a **possible obligation** that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

- a **present obligation** that arises from past events but is not recognised because it is either not probable that future economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability (i.e. the definition of a liability is satisfied, but one or both of the recognition criteria is not satisfied).

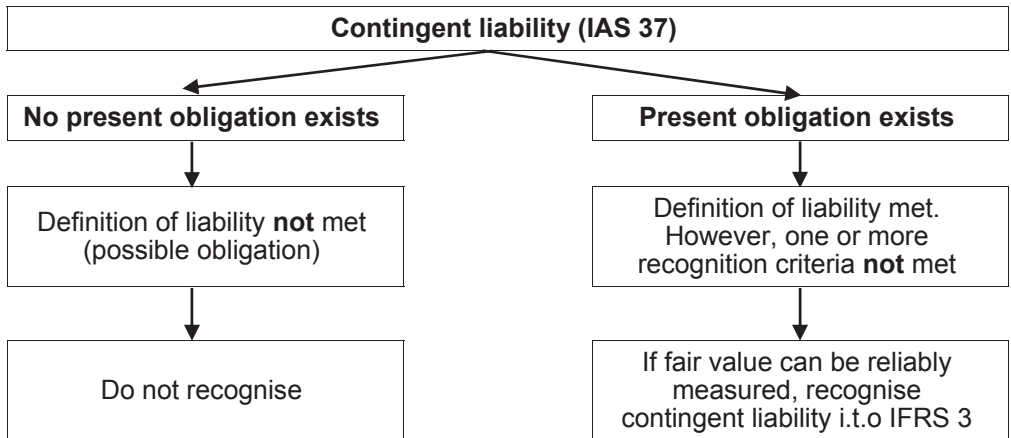
However, a contingent liability assumed in a business combination shall be recognised by the acquirer at the acquisition date if:

- it is a **present obligation** that arises from past events; and
- its fair value can be reliably measured.

The contingent liability (as a present obligation, meeting the definition of a liability) is therefore recognised by the acquirer at fair value, even if it is not probable that an outflow of economic benefits will be required to settle the obligation.

A **contingent asset** is defined in accordance with **IAS 37 Provisions, Contingent Liabilities and Contingent Assets** as a **possible asset** that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. The acquirer **shall not recognise a contingent asset** at the acquisition date.

The exception with regard to contingent liabilities can be summarised as follows:



Example 9.8	Contingent liabilities
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On 1 January 20.29, P Ltd acquired a 90% interest in S Ltd for R550 000. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. On 1 January 20.29, S Ltd's equity amounted to R500 000 and a claim for damages was filed against S Ltd for damages caused by the company. S Ltd was defending the claim and its lawyers were of the opinion that there was only a remote possibility that the claim would succeed. Although the claim represents a present obligation (i.e. S Ltd was responsible for damages caused), S Ltd did not recognise the liability in its individual financial statements as the possibility of the outflow of economic benefits was remote (i.e. not probable). The fair value of the contingent liability was estimated at R45 000 at the acquisition date. The reporting date of the group is 31 December 20.29.

Ignore any tax consequences.

P Ltd would have taken this contingent liability into account in considering the fair value of the identifiable net assets of S Ltd and in determining the amount of the consideration for the business combination. In accounting for the business combination, P Ltd will therefore **recognise the contingent liability** at R45 000 in the combined entity at the acquisition date.

The **pro forma consolidation journal** entries at the date of acquisition will be as follows:

		Dr R	Cr R
J1	Equity at acquisition (SCE) Contingent liability (SFP) Recognition of contingent liability i.t.o. IFRS 3	45 000	45 000
J2	Equity of S Ltd (SCE) (500 000 – 45 000) Goodwill (SFP) Investment in S Ltd (SFP) Non-controlling interests (SCE) (455 000 × 10%) Elimination of investment against equity at acquisition	455 000 140 500	550 000 45 500



Comment

Should S Ltd subsequently recognise a provision relating to the claim in its individual accounting records, the group will **reverse** the “at acquisition fair value adjustment” relating to the contingent liability.

Subsequent measurement

On 30 November 20.29, new evidence emerged in the claim against S Ltd. The lawyers advised S Ltd that the most likely and probable outcome is settlement amounting to R60 000; however, a court date has not yet been set. Accordingly, S Ltd recognised a provision of R60 000 in its individual accounting records. S Ltd made a profit of R100 000 for the 20.29 financial year.

The consolidation journals on **31 December 20.29** (reporting date) will be as follows:

		Dr R	Cr R
J1	Equity at acquisition (SCE) Contingent liability (SFP) Recognition of contingent liability i.t.o IFRS 3	45 000	45 000
J2	Equity of S Ltd (SCE) (500 000 – 45 000) Goodwill (SFP) Investment in S Ltd (SFP) Non-controlling interests (SCE) (455 000 × 10%) Elimination of investment against equity at acquisition	455 000 140 500	550 000 45 500
J3	Contingent liability (SFP) Legal expenses (P/L) Reversal of fair value adjustment at acquisition	45 000	45 000
J4	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of NCI's portion of the profit for the year ((100 000 + 45 000) × 10%)	14 500	14 500



Comment

In the subsequent financial year (20.30) the reversal of the fair value adjustment made at acquisition (J3) will still be required. It will however be debited to the opening balance of retained earnings instead of profit or loss.

2 Exceptions to both the recognition and measurement principles

Deferred tax

A deferred tax asset or liability arising from the acquisition of the assets and assumption of the liabilities in the business combination shall be recognised and measured by the acquirer in accordance with **IAS 12 Income Taxes**. It is important to note that the initial recognition exemption in respect of deferred tax does not apply to temporary difference that arose from a business combination. A deferred tax liability or asset is therefore recognised on all temporary differences. The potential tax effects of temporary differences and carry-forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition shall also be recognised and measured in accordance with IAS 12.

Example 9.9**Deferred tax on fair value remeasurements of an asset**

The date of the business combination of P Ltd and S Ltd is 1 March 20.29. On this date the carrying amount of the plant of S Ltd was R700 000 and the tax base was R600 000. The tax rate is 27%. S Ltd recognised a deferred tax liability of R27 000 in respect of this plant. On 1 March 20.29 the fair value of the plant was R730 000.

For the purpose of the **business combination**, the plant will be recognised at its fair value of R730 000. The remeasurement of R30 000 (R730 000 – R700 000) is recognised as **equity at acquisition**. An adjustment of R8 100 (R30 000 × 27%) is also recognised for the deferred tax liability.

Details of the deferred tax calculation are as follows:

	Carrying amount	Tax base	Temporary difference	Deferred tax liability	Adjustment
Balance on 1 March 20.29	R700 000	R600 000	R100 000	R27 000	
Business combination	R730 000	R600 000	R130 000	R35 100	R8 100

Example 9.10**Subsequent recognition of deferred tax asset**

P Ltd acquired a 100% interest in S Ltd on 1 December 20.28. On this date S Ltd had an assessed loss of R500 000. S Ltd did not recognise a deferred tax asset, as there was no certainty regarding future taxable income and thus no tax asset was recognised in the consolidated financial statements.

On 31 December 20.29 (reporting date) S Ltd assessed that future taxable profit should be sufficient to recover the total benefit of the assessed loss of R500 000. Assume a tax rate of 27%.

On 31 December 20.29 S Ltd will recognise a deferred tax asset of R135 000 (R500 000 × 27%) in S Ltd's **individual** financial statements. No consolidation journals are required in respect of this deferred tax asset. S Ltd recognised the deferred tax asset (SFP) and the benefit thereof (P/L), which is also the correct treatment in the consolidated financial statements.

Employee benefits

The acquirer shall recognise and measure a liability or asset related to the acquiree's employee benefit arrangements in accordance with **IAS 19 Employee Benefits**.

Indemnification assets

The seller in the business combination (i.e. the acquiree) may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, a seller may guarantee that an acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset.

The acquirer shall **recognise** the indemnification asset at the same time it recognises the indemnified item, and **measures** the indemnification asset on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. If the indemnified asset or liability is therefore recognised at fair value on the acquisition date, the indemnification asset will also be recognised at fair value on the acquisition date. If the indemnification asset is measured at fair value, the uncertainty

about future cash flows because of collectability is included in the fair value and a separate valuation allowance for uncollectible amounts is not necessary.

If an indemnification asset relates to an item that is an exception to the recognition or measurement principles, for example a contingent liability that is not recognised at the acquisition date as its fair value cannot be reliably measured, or an item that is not measured at the acquisition date fair value, e.g. an employee benefit liability, the indemnification asset shall be recognised and measured using assumptions consistent with those used to recognise and measure the indemnified item.

Example 9.11	Indemnification asset
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P Ltd acquires a 60% interest in S Ltd on 1 July 20.25 from Q Ltd. From that date P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. On this date S Ltd is also involved in a court case in terms of which S Ltd may be liable to pay damages amounting to R2,5 million for violating Z Ltd's patent rights. Although S Ltd's lawyers are of the opinion that the patent rights were indeed violated (i.e. a present obligation exists), there is a possibility that the court's ruling may be in S Ltd's favour. It is therefore not possible to predict the outcome of the court case on 1 July 20.25. Should the ruling not be in S Ltd's favour, Q Ltd agrees contractually **to reimburse S Ltd** for 60% of the damages payable to Z Ltd. The fair value of the potential liability to pay damages to Z Ltd amounts to R500 000 at 1 July 20.25.

Ignore any tax consequences.

From S Ltd's perspective, the court case represents a **contingent liability**, as there is a present obligation to pay damages (patent rights were violated), but the outflow of future economic benefits is not probable (court's ruling uncertain). Although S Ltd does not recognise this contingent liability in its individual financial statements, it should be recognised in the consolidated financial statements at acquisition date at fair value when accounting for the business combination. As the indemnified liability is recognised at acquisition date at fair value, the **indemnification asset** should also be recognised at acquisition date at fair value (note that S Ltd will not recognise this indemnification asset in its individual financial statements at acquisition date, as it represents a contingent asset at that date).

The following **pro forma consolidation journal** entry will be required at acquisition date:

		Dr R	Cr R
J1	1 July 20.25 Equity at acquisition (SCE) Indemnification asset (SFP) (500 000 × 60%) Recognised contingent liability (SFP) Recognition of contingent liability and indemnification asset as part of the business combination	 200 000 300 000	 500 000

If there are indications at the **end of the reporting period** (31 December 20.25) that the claim will succeed and the amount of the claim is estimated at R2 million, S Ltd will recognise a **provision** of R2 million in its individual financial statements, as the outflow of

economic benefits are now probable. S Ltd will then also recognise a **reimbursement asset** of R1,2 million (2 million × 60%). For consolidation purposes the liability should be measured at the higher of R500 000 (amount initially recognised) and R2 million (amount recognised in accordance with IAS 37) – therefore R2 million, while an indemnification asset of R1,2 million should also be recognised. As the individual financial statements of S Ltd already include the provision and the reimbursement asset, it will be necessary to reverse the liability of R500 000 and indemnification asset of R300 000 recognised at acquisition date.

The following additional consolidation journal is required:

		Dr R	Cr R
J1	31 December 20.25		
	Recognised contingent liability (SFP)	500 000	
	Indemnification asset (SFP)		300 000
	Other expenses (law-suit) (P/L)		200 000
	Reversal of contingent liability and indemnification asset		

	Comment The effect of the above two consolidation journals is that the P Ltd Group recognises a liability of R500 000 and an asset of R300 000 on 1 July 20.25, which are then adjusted to R2 million and R1,2 million respectively at 31 December 20.25. The adjustment of R600 000 is included in profit or loss and consists of the net expense of R800 000 (2 million – 1,2 million) recognised by S Ltd when the provision and reimbursement asset was raised, less the above adjustment of R200 000 on 31 December 20.25.
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Leases in which the acquiree is the lessee

The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with IFRS 16 in which the acquiree is the lessee, except for:

- ☐ leases for which the lease term ends within 12 months of the acquisition date; or
- ☐ leases for which the underlying asset is of low value (as described in IFRS 16).

The acquirer shall measure the lease liability at the **present value of the remaining lease payments** (as defined in IFRS 16) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

Example 9.12	Recognition and measurement of a favourable lease for the lessee
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On 1 January 20.29, P Ltd acquired a 75% interest in S Ltd. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. On 1 January 20.28, S Ltd signed a lease agreement as lessee in respect of a specific building situated in a prime business area with Z Ltd. The lease agreement stated that the lease payment of R50 000 per annum was payable in arrears and, at the inception of the lease, S Ltd's incremental borrowing rate was 16%. On 1 January 20.29, the

remaining lease term was five years, a market-related lease payment for similar buildings was R58 000 per annum, and S Ltd's incremental borrowing rate reduced to 15%.

Ignore any tax consequences.

At the acquisition date (1 January 20.29), P Ltd shall **firstly** measure the lease liability and right-of-use asset at R167 608, calculated as $\text{Pmt} = 50\,000$; $i = 15\%$; $n = 5$; $\text{FV} = 0$ (the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date).



Comment

A favourable component to the lease agreement arises from the favourable terms of the lease agreement. The annual instalment payable by S Ltd is only R50 000, while a market-related instalment amounts to R58 000.

Secondly, P Ltd will adjust the value of the right-of-use asset to reflect the favourable terms of the lease when compared with market terms. The favourable component of the lease equals R26 817 ($\text{Pmt} = (58\,000 - 50\,000)$; $i = 15\%$; $n = 5$; $\text{FV} = 0$). Therefore, the fair value of the right-of-use asset will be R194 425 ($\text{R167 608} + \text{R26 817}$).



Comment

The fair value of the right-of-use asset can also be calculated as the present value of the market-related instalments of R58 000 discounted at 15% ($\text{Pmt} = 58\,000$; $i = 15\%$; $n = 5$; $\text{FV} = 0$).

S Ltd already accounted for the lease agreement in its **individual accounting records** according to IFRS 16. Therefore, the pro forma consolidation journal entries will account for the difference between the carrying amount of the lease liability and right-of-use asset in S Ltd's accounting records and the fair value as calculated in accordance with IFRS 3.

	S Ltd	Group	Difference
Lease liability 1 January 20.29	⁽¹⁾ 163 715	⁽⁵⁾ 167 608	3 893
Finance costs	⁽²⁾ 26 194	⁽⁶⁾ 25 141	(1 053)
Lease instalment	(50 000)	(50 000)	–
Lease liability 31 December 20.29	R139 909	R142 749	R2 840
Right-of-use asset 1 January 20.29	⁽³⁾ 153 531	⁽⁷⁾ 194 425	40 894
Depreciation	⁽⁴⁾ (30 706)	⁽⁸⁾ (38 558)	(8 179)
Right-of-use asset 31 December 20.29	R122 825	R155 867	R32 715

(1) $\text{Pmt} = 50\,000$; $i = 16\%$; $n = 5$; $\text{FV} = 0$

(2) $163\,715 \times 16\%$

(3) $(\text{Pmt} = 50\,000; i = 16\%; n = 6; \text{FV} = 0) \times 5/6$

(4) $153\,531/5$ or $184\,237/6$

(5) $\text{Pmt} = 50\,000$; $i = 15\%$; $n = 5$; $\text{FV} = 0$

(6) $167\,608 \times 15\%$

(7) $\text{Pmt} = 58\,000$; $i = 15\%$; $n = 5$; $\text{FV} = 0$

(8) $194\,425/5$

The **pro forma consolidation journal** entry at the date of acquisition will be as follows:

		Dr R	Cr R
J1	1 January 20.29 Right-of-use asset (SFP) (194 425 – 153 531) Lease liability (SFP) (167 608 – 163 715) Equity at acquisition (SCE) Remeasurement of lease agreement	40 894	3 893 37 001

The following consolidation journal entry will be required at the reporting date (**31 December 20.29**):

		Dr R	Cr R
J1	Depreciation (P/L) Right-of-use asset (SFP) Financial liability (SFP) Finance costs (P/L) Adjustment of depreciation and finance costs for 20.29	8 179 1 053	8 179 1 053

3 Exceptions to the measurement principle

Reacquired rights

The acquirer can reacquire a right that it had previously granted to the acquiree, such as the right to use one or more of the acquirer’s recognised or unrecognised assets. This right is recognised separately from goodwill. An example is the acquisition of the right to use its trade name under a franchise agreement that the acquirer had previously granted to the acquiree.

Share-based payment awards

The acquirer shall measure a liability or an equity instrument related to the replacement of an acquiree’s share-based payment awards with share-based payment awards of the acquirer in accordance with the method in **IFRS 2 Share-based Payment**. This method is called the “market-based measure” of the award. Refer to IFRS 3.B56–.B62 and .IE61–.IE71 for detailed guidance and illustrations.

Assets held for sale

The acquirer shall measure an acquired non-current asset held for sale (or disposal group held for sale) at the acquisition date in accordance with **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** at fair value less costs to sell (refer to IFRS 5.15–.18).

Example 9.13**Non-current assets held for sale**

S Ltd classified a machine as held for sale on 31 March 20.25, when the carrying amount of the machine amounted to R250 000 and the fair value less costs to sell amounted to R275 000. P Ltd acquired an 80% interest in S Ltd on 31 May 20.25, when the machine's fair value less costs to sell amounted to R287 500. From this date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. At the reporting date (30 June 20.25), the machine's fair value less costs to sell decreased to R280 000. Ignore any tax consequences.

In the individual financial statements of S Ltd the machine should be measured on 31 March 20.25 at the lower of its carrying amount (R250 000) and its fair value less costs to sell (R275 000), i.e R250 000. When accounting for the business combination on 31 May 20.25, the machine should be measured in the consolidated financial statements at its fair value less costs to sell of R287 500.

The following **pro forma consolidation journal** entry is required:

		Dr R	Cr R
J1	31 May 20.25 Non-current assets held for sale (SFP) Equity at acquisition (SCE) Remeasurement of non-current asset held for sale (287 500 – 250 000)	37 500	37 500

At the end of the reporting period the machine should be **remeasured to the lower of its carrying amount and fair value less costs to sell**. In the individual financial statements of S Ltd no adjustment is required – measured at the lower of the carrying amount (R250 000) and fair value less costs to sell (R280 000). In the consolidated financial statements the machine should be measured at the lower of R287 500 (carrying amount) and R280 000 (fair value less costs to sell). An impairment loss of R7 500 should thus be recognised in the consolidated financial statements.

The following consolidation journal is required:

		Dr R	Cr R
J1	30 June 20.25 Impairment loss (P/L) Non-current asset held for sale (SFP) Remeasurement of non-current asset held for sale (287 500 – 280 000)	7 500	7 500

Consideration transferred

9.5 Measurement of consideration transferred

The consideration transferred in a business combination should be measured at fair value determined at acquisition date. The consideration is calculated as the sum of the fair values of:

- ☐ the assets transferred by the acquirer (cash, property, plant and equipment, investments, businesses or subsidiaries of the acquirer);

- ☐ the liabilities incurred by the acquirer (settlement of the purchase price at a future date); and
- ☐ the equity interests issued by the acquirer (ordinary shares, preference shares and options).

The carrying amount of assets and liabilities transferred as part of consideration may be different from their fair values at acquisition date. If so, the acquirer should remeasure the transferred assets or liabilities to their fair values as at the acquisition date and should then recognise the resulting gains or losses, if any, in profit or loss.

Example 9.14	Measurement of consideration transferred
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On 1 January 20.25, P Ltd acquired a 55% interest in S Ltd. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. The purchase price was settled as follows:

- ☐ A cash payment of R1 750 000 on 1 January 20.25.
- ☐ The issue of 10 000 shares on 15 January 20.25. The fair value of these shares amounted to R350 000 on 1 January 20.25 and R385 000 on 15 January 20.25.
- ☐ The transfer of land, with a carrying amount of R525 000. The fair value of the land amounted to R700 000 on 1 January 20.25 and R787 500 on 31 January 20.25, when the transfer of the land was formally registered.
- ☐ As P Ltd did not have sufficient cash reserves, it was agreed that the outstanding amount of R1 225 000 will be paid on 31 December 20.26. The fair value of this liability amounted to R1 050 000 on 1 January 20.25.

Ignore any tax consequences.

The fair value of the consideration transferred will amount to R3 850 000 (1 750 000 (cash) + 700 000 (land) + 350 000 (shares) + 1 050 000 (liability)). The fair value of the land and shares should be determined at the **acquisition date** (1 January 20.25). The requirement to measure liabilities at fair value necessitates the calculation of the present value whenever settlement of the purchase consideration is deferred (the difference between the present value (R1 050 000) and the amount payable (R1 225 000) should be accounted for as **interest paid** over two years, using the effective interest method). The transfer of land will result in a gain of R175 000 (700 000 – 525 000) being recognised in profit or loss.

The journal entry to account for the acquisition of S Ltd in the **separate** financial statements of **P Ltd** will be as follows:

		Dr R	Cr R
J1	Investment in S Ltd (SFP)	3 850 000	
	Bank (SFP)		1 750 000
	Share capital (SCE)		350 000
	Financial liability (SFP)		1 050 000
	Property, plant and equipment (Land) (SFP)		525 000
	Gain on transfer of land (P/L)		175 000
	Recognising the acquisition of S Ltd		

**Comment**

In the above example, the land was transferred to the former owners of the acquiree (which are external to the group). If, however, the transferred assets or liabilities remain within the combined entity after the business combination, for example, because the assets or liabilities were transferred to the acquiree (subsidiary), and, therefore, the acquirer effectively retains control of them (by controlling the subsidiary), the assets and liabilities should be measured at their carrying amounts immediately before the acquisition date and no gain or loss should be recognised in the group. This will happen, for example, if the acquirer obtains its interest in the acquiree directly from the acquiree instead of its shareholders (the acquiree issues shares to the acquirer in exchange for the transfer of an asset).

Example 9.15**Measurement of consideration transferred – Asset**

S Ltd was incorporated on 1 January 20.25, on which date it issued all of its authorised share capital to P Ltd in exchange for land owned by P Ltd. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. The land had a carrying amount of R1 125 000 in the accounting records of P Ltd and a fair value of R1 575 000 at that date.

Ignore any tax consequences.

The journal entry to account for the acquisition of S Ltd in the **separate** financial statements of **P Ltd** is as follows:

		Dr R	Cr R
J1	Investment in S Ltd (SFP) Property, plant and equipment (Land) (SFP) Profit on the transfer of land (P/L) Recognising the acquisition of S Ltd	1 575 000	1 125 000 450 000

The journal entry to account for the issue of the shares in the **individual** financial statements of **S Ltd** is as follows:

		Dr R	Cr R
J1	Property, plant and equipment (Land) (SFP) Share capital (SCE) Issuing of shares	1 575 000	1 575 000

S Ltd has issued shares worth R1 575 000 in exchange for land worth R1 575 000. In accordance with IAS 16.16 the land should be measured at its purchase price, which is R1 575 000.

In the **consolidated financial statements**, it would not be appropriate to recognise a gain on the transfer of the land, as P Ltd retained control of the land. In addition, the land should be recognised in the consolidated financial statements at its previous carrying amount of R1 125 000 and not at the fair value of R1 575 000.

The following **pro forma consolidation journal** entry should be processed:

		Dr R	Cr R
J1	Share capital of S Ltd (SCE)	1 575 000	
	Investment in S Ltd (SFP)		1 575 000
	Profit on the transfer of land (P/L)	450 000	
	Property, plant and equipment (land) (SFP)		450 000
	Reversal of intragroup profit; elimination of common items		

An acquirer sometimes obtains control of an acquiree without transferring consideration. Examples can include:

- ☐ The acquiree repurchases a sufficient number of its own shares, for an existing investor (the acquirer) to obtain control.
- ☐ Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.
- ☐ The acquirer and acquiree agree to combine their businesses by contract alone.

If the business combination is achieved by contract alone, the acquirer shall account for the equity interests held by other parties as non-controlling interests in the consolidated financial statements. Refer to example 14.4 for an example on the accounting treatment of obtaining control through an agreement.

9.6 Measurement of contingent consideration transferred

The acquirer may agree to transfer additional equity interests, cash, or other assets to the former owners of the acquiree after the acquisition date, provided that specified events occur, for example if certain profit levels are reached – this is referred to as **contingent consideration**.

Contingent consideration is defined as an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. The fair value of this contingent consideration as at acquisition date should be included in the fair value of the total consideration that the acquirer transfers in exchange for the acquiree (the fair value of the contingent consideration reflects the probability that it will be paid).

The obligation to pay contingent consideration should be classified as a financial liability or as equity, based on the definitions of an equity instrument and financial liability contained in IAS 32. If the obligation is not classified as equity or a financial liability, it should be classified as a liability in terms of other standards. When measuring the fair value of contingent payments, the acquirer's agreement to make contingent payments is the obligating event that requires the recognition of a liability at acquisition date.

Contingent consideration may also give the acquirer the right to the return of previously transferred considerations if specified future events occur or conditions are met, for example where a portion of the purchase price will be repaid if profits fall below a certain level. **Contingent considerations receivable** should be taken into account when measuring the total consideration relating to the business combination. This will be accounted for as a reduction in the total consideration transferred and the fair value

thereof will reflect the probability that it will be received. The right to receive this contingent consideration should be classified as an **asset**.

Subsequent changes may occur in the fair value of the assets and liabilities recognised for consideration receivable or payable. If these changes result from additional information obtained after the acquisition date regarding circumstances that already existed at acquisition date, the financial statements should be corrected retrospectively, provided the adjustment is made within one year from acquisition date. This is referred to as a measurement period adjustment.

Changes in fair value, resulting from events that occurred only after the acquisition date, such as share price and profit targets being met, are not regarded as measurement period adjustments and are not accounted for retrospectively. Refer to paragraph 9.7 for a detailed discussion on measurement period adjustments. Instead, these changes in fair value are accounted for as follows:

- ☐ Contingent consideration classified as equity is not remeasured. When the amount is settled, the settlement is accounted for within equity.
- ☐ Contingent consideration classified as a financial asset or liability within the scope of IFRS 9 should be measured to fair value at each reporting date. Any gains or losses will be recognised in profit or loss in the period after the business combination.
- ☐ Contingent consideration classified as an asset or liability not within the scope of IFRS 9 should also be measured to fair value at each reporting date. Any gains or losses will be recognised in profit or loss in the period after the business combination.



Comment

It should be noted that most contingent consideration obligations are financial instruments, and many are derivatives, as the value of the obligation changes, no initial net investment is required and settlement is at a future date.

Example 9.16

Contingent consideration – Financial liability

On 1 January 20.25, P Ltd acquired a 60% interest in S Ltd. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. At 1 January 20.25, the fair value of the identifiable net assets of S Ltd amounted to R375 000, while the fair value of the 40% non-controlling interests amounted to R125 000 (the non-controlling interests in the acquiree is measured at fair value). The purchase price was settled as follows:

- ☐ R500 000 in cash;
- ☐ P Ltd also agreed to pay the previous owners of S Ltd an additional amount of R75 000 in cash if the earnings of S Ltd increases by more than 10% per year for two consecutive years. On 1 January 20.25, the fair value of this obligation is estimated at R57 500 (taking into account the probability of meeting the earnings target, as well as the time value of money).

On 31 December 20.25 (reporting date), the earnings of S Ltd have increased by 11%. As the probability of payment increases, and as a result of the payment being one period closer, the fair value of the liability is R65 000 on 31 December 20.25.

On 31 December 20.26, the earnings of S Ltd have increased by 12% and P Ltd is obligated to pay the additional consideration of R75 000.

P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.

Ignore any tax consequences.

In its **separate financial statements**, **P Ltd** will process the following journal entry on 1 January 20.25:

		Dr R	Cr R
J1	Investment in S Ltd (SFP) Bank (SFP) Financial liability at fair value through P/L (SFP) Recognising contingent consideration as part of the consideration transferred for the business combination	557 500	500 000 57 500

On 31 December 20.25, the financial liability is remeasured to fair value:

		Dr R	Cr R
J2	Fair value adjustment (P/L) Financial liability at fair value through P/L (SFP) Fair value adjustment of the financial liability for contingent consideration (65 000 – 57 500)	7 500	7 500

On 31 December 20.26, the following journal entries will be required:

		Dr R	Cr R
J3	Fair value adjustment (P/L) Financial liability at fair value through P/L (SFP) Fair value adjustment of the financial liability for contingent consideration (75 000 – 65 000)	10 000	10 000
J4	Financial liability at fair value through profit or loss (SFP) Bank (SFP) Settlement of the contingent consideration	75 000	75 000

The following **pro forma consolidation journal** entry will be required to eliminate the at acquisition equity of S Ltd:

		Dr R	Cr R
J1	Equity at acquisition (SCE) Goodwill (SFP) ((557 500 + 125 000) – 375 000) Investment in S Ltd (SFP) Non-controlling interests (SCE) Elimination of at acquisition equity	375 000 307 500	557 500 125 000

If the contingent consideration will be settled by the issuing of P Ltd's shares (equal to R75 000), the amount will still be classified as a financial liability. This is so because IAS 32 requires contracts that will be settled in a variable number of the entity's own shares to be classified as a financial liability. Assuming that P Ltd's share price is R12,50 on this date, all the journal entries will remain the same, except for the entry to be processed on 31 December 20.26 by **P Ltd**, which will be as follows:

		Dr R	Cr R
J1	Fair value adjustment (P/L) Financial liability at fair value through profit or loss (SFP) (75 000 – 65 000) Fair value adjustment of the financial liability for contingent consideration	10 000	10 000
J2	Financial liability at fair value through profit or loss (SFP) Share capital (SCE) Settlement of the contingent consideration	75 000	75 000

If the parties agreed that P Ltd will settle the contingent consideration by issuing 6 000 shares, the amount will be classified as equity. This is because IAS 32 requires contracts that will be settled in a fixed number of the entity's own shares to be classified as equity. Equity instruments are not remeasured in accordance with IAS 32. In such a case, **P Ltd** will process the following journal entry on 1 January 20.25:

		Dr R	Cr R
J1	Investment in S Ltd (SFP) Bank (SFP) Equity (SCE) (contract to issue shares) Recognising contingent consideration as part of the consideration transferred for the business combination	557 500	500 000 57 500

On 31 December 20.26, the following journal entry will be required:

		Dr R	Cr R
J2	Equity (SCE) (contract to issue shares) Share capital (SCE) Settlement of the contingent consideration	57 500	57 500

Example 9.17**Contingent consideration – Asset**

On 31 December 20.25 (reporting date), P Ltd acquires an 80% interest in S Ltd at a cost of R2,5 million. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. In terms of the purchase agreement, 6% of the selling price amount will be repaid by the sellers to P Ltd if the profits of S Ltd fall below R500 000 per annum in any of the next two years.

Ignore any tax consequences.

At the acquisition date, an estimate should be made of the **fair value of the contingent consideration** (the amount that may be received from the sellers). The fair value should take into account the time value of money, as well as the probability that the amount will be received. If it is assumed that the fair value of this receivable is R25 000 (low fair value as it is expected that profits will exceed R500 000 per annum), the fair value of the total consideration will amount to R2,475 million (2,5 million – 25 000).

On 31 December 20.25, the following journal entry will appear in **the separate financial accounts of P Ltd**:

		Dr R	Cr R
J1	Investment in S Ltd (SFP) Financial asset (SFP) Bank (SFP) Recognising the consideration transferred to acquire an 80% interest in S Ltd	2 475 000 25 000	2 500 000

If expectations at acquisition date are that the profit targets will be reached but, due to an increase in interest rates subsequent to acquisition date there is a downward trend in the economy, resulting in the targets not being met, the **fair value of the consideration should not be adjusted retrospectively**. Instead, the difference between the initial fair value of R25 000 and the amount received of R150 000 (6% × R2,5 million) should be recognised in profit or loss.

**Comment**

If, after the acquisition date, information is obtained which confirms that the sellers of the interest in S Ltd supplied fraudulent profit forecasts to P Ltd during negotiations and that, based on the correct information as at acquisition date, the profits of S Ltd will definitely not exceed R500 000 per annum, the fair value of the consideration transferred **should be adjusted retrospectively**, by restating comparatives as the fraudulent information meets the definition of a prior period error in accordance with IAS 8.

Example 9.18**Compensation for reduction in equity instruments**

On 1 January 20.25, P Ltd acquires a 60% interest in S Ltd by issuing 10 000 shares with a fair value of R25 each as settlement of the purchase price. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. P Ltd undertakes to issue additional shares if the fair value of its shares decreases within the first year after acquisition of S Ltd. On 1 January 20.25, expectations are that the share price of P Ltd will increase in future and therefore the fair value of the potential obligation to issue additional shares amounts to R15 000. However, the share price of P Ltd dropped during December and on 31 December 20.25 (reporting date), the fair value of P Ltd's shares amounted to R15 each.

Ignore any tax consequences.

The fair value of the consideration transferred is R265 000 and consists of the fair value of the 10 000 shares issued on 1 January 20.25, amounting to R250 000 ($10\,000 \times 25$) as well as the fair value of the contingent consideration of R15 000. The obligation to issue additional shares if the share price decreases, represents a financial liability, as the number of shares issued depends on the extent of the reduction in the share price. When the value of the shares decreases on 31 December 20.25, additional shares need to be issued.

The following journal entries will appear in **the separate financial accounts of P Ltd**:

		Dr R	Cr R
J1	1 January 20.25 Investment in S Ltd (SFP) Share capital (SCE) ($25 \times 10\,000$) Financial liability (SFP) Fair value of consideration transferred	265 000	250 000 15 000
J2	31 December 20.25 Fair value adjustment (P/L) Financial liability (SFP) Remeasurement of financial liability to fair value ((($25 - 15$) $\times 10\,000$) – 15 000)	85 000	85 000
J3	Financial liability (SFP) Share capital (SCE) Settlement of liability	100 000	100 000

Measurement period

9.7 Measurement period adjustments

In the sections above, it was indicated that the acquirer needs to identify and recognise all the assets and liabilities of the acquiree. Furthermore, the fair value of the various assets, liabilities, non-controlling interests, consideration, etc., needs to be obtained. From a practical point of view, one should bear in mind that all these requirements are very time-consuming. The measurement period in IFRS 3 therefore allows the acquirer some leeway to finalise all the required procedures to complete the accounting of the business combination properly.

If the initial accounting for the business combination is **incomplete** at the end of the reporting period in which the combination transaction occurs, the acquirer shall **report provisional amounts** in its financial statements for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the measurement of the amounts recognised at the acquisition date.

During the measurement period, the acquirer shall also recognise additional assets and liabilities if new information is obtained about facts and circumstances that existed at the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities at the acquisition date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed at the acquisition date or learns that more information is not obtainable. However, the measurement period shall **not exceed more than one year from the acquisition date**.

The effect of the above principle is that goodwill is subsequently adjusted for such changes due to the fact that the changes resulting from new information are processed retrospectively, as if the information had existed at the acquisition date. This results in a fairer presentation of the goodwill (or gain from a bargain purchase) at the acquisition date.

It is very important to note that not all information obtained in the measurement period will result in changes to the provisional amounts at the acquisition date. The acquirer should apply professional judgement to ensure that the new information reflects the circumstances that **existed at the acquisition date** and not those that arose thereafter. The shorter the time period between the estimate of the provisional amount at the acquisition date and the receipt of additional information about the provisional amount in the measurement period, the more likely the new information will relate to a circumstance that existed at the acquisition date. The opposite is also true.

After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with **IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors**.

Example 9.19	Measurement period and adjustment to goodwill
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The date of the business combination of P Ltd and S Ltd is 1 December 20.28. P Ltd acquired a 55% interest in S Ltd. By the end of the reporting period of the group (31 December 20.28), P Ltd determined the fair value of the identifiable net assets (excluding plant) to be R2,4 million. The plant was provisionally valued at R600 000. The business combination was effected through the transfer of R1,5 million in cash and through the transfer of another investment to the seller. The other investment was provisionally valued at R300 000.

The non-controlling interests are measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date.

P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.

Ignore any tax consequences.

By 31 December 20.28, the **goodwill** arising from the business combination at 1 December 20.28 was provisionally calculated as follows:

Consideration transferred (R1,5 million + R300 000)	1 800 000
Non-controlling interests [45% × (R2,4 million + R600 000)]	1 350 000
	<u>3 150 000</u>
Less: Net identifiable assets acquired (R2,4 million + R600 000)	(3 000 000)
Goodwill (provisional)	<u>R150 000</u>

During March 20.29, P Ltd obtained the final valuation reports from an expert. The fair value of plant on 1 December 20.28 was R650 000, while the fair value of the investment transferred was R290 000. Furthermore, P Ltd did not identify any additional assets acquired or liabilities assumed as at 1 December 20.28.

The **final goodwill** from the business combinations at 1 December 20.28 will be calculated as follows:

Consideration transferred (R1,5 million + R290 000)	1 790 000
Non-controlling interests [45% × (R2,4 million + R650 000)]	1 372 500
	<u>3 162 500</u>
Less: Net identifiable assets acquired (R2,4 million + R650 000)	(3 050 000)
Goodwill (final)	<u>R112 500</u>

The amount for goodwill, as presented in the consolidated statement of financial position as at 31 December 20.28, will therefore be **retrospectively adjusted** by R37 500 (i.e. R150 000 – R112 500) to reflect the true goodwill of R112 500 as at the date of the acquisition (1 December 20.28).

The **pro forma consolidation journal** entry will be as follows:

		Dr R	Cr R
J1	1 December 20.28		
	Equity at acquisition (SCE)	3 000 000	
	Goodwill (SFP) (balancing)	150 000	
	Non-controlling interests (SCE)		1 350 000
	Investment in S Ltd (SFP)		1 800 000
	At acquisition elimination journal of S Ltd		

The provisional amounts used for the valuation of the plant and the investment transferred will be **retrospectively adjusted to the final** valuation amounts in the subsequent financial period. Consolidation journals are **repeated every year** and therefore the final valuation amounts will be used in the 20.29 elimination journal.

		Dr R	Cr R
J1	31 December 20.29		
	Equity at acquisition (SCE)	3 050 000	
	Goodwill (SFP) (balancing)	112 500	
	Non-controlling interests (SCE)		1 372 500
	Investment in S Ltd (SFP)		1 790 000
	At acquisition elimination journal of S Ltd		

Example 9.20	Measurement period adjustment – Non-controlling interests measured at proportionate share
---------------------	--

P Ltd acquired an 80% interest in S Ltd on 1 December 20.25 for R1 750 000. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. The net assets (excluding machinery) of S Ltd had a fair value of R1,5 million. At that date the machinery of S Ltd had a remaining useful life of five years and a carrying amount of R500 000. P Ltd sought an independent appraisal for the machinery owned by S Ltd, which was only finalised during March 20.26. Initially the value of the machinery was estimated at R600 000, but the appraisal indicated a fair value of R675 000 (the difference in fair value related to circumstances that existed at acquisition date). The financial statements of P Ltd for the reporting period ended 31 December 20.25 were issued on 28 February 20.26.

The non-controlling interests are measured at their proportionate share of S Ltd's identifiable net assets.

P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.

Ignore any tax consequences.

When preparing the consolidated financial statements for the reporting period ended 31 December 20.25, a value of R600 000 will be assigned to the machinery.

The **pro forma consolidation journal** entries for 20.25 will be as follows:

		Dr R	Cr R
J1	Machinery (SFP) Equity at acquisition (SCE) Remeasurement of machinery to provisional fair value (600 000 – 500 000)	100 000	100 000
J2	Equity at acquisition (SCE) (1 500 000 + 600 000) Goodwill (SFP) (balancing) Non-controlling interests (SCE) (2 100 000 × 20%) Investment in S Ltd (SFP) Elimination of investment against equity at acquisition	2 100 000 70 000	420 000 1 750 000
J3	Depreciation (P/L) Accumulated depreciation (SFP) Additional depreciation for 20.25 due to fair value remeasurement (100 000/5 × 1/12)	1 667	1 667
J4	Non-controlling interests (SCE) Non-controlling interests (P/L) Non-controlling interests in additional depreciation for 20.25 (1 667 × 20%)	333	333

The provisional amount used for the machinery will be corrected in the 20.26 financial statements by means of a retrospective adjustment, as the amount is finalised within 12 months from the acquisition date.

The pro forma consolidation journal entries for **20.26** will therefore be as follows:

		Dr R	Cr R
J1	Machinery (SFP) Equity at acquisition (SCE) Remeasurement of machinery to final fair value (675 000 – 500 000)	175 000	175 000
J2	Equity at acquisition (SCE) (1 500 000 + 675 000) Goodwill (SFP) (balancing) Non-controlling interests (SCE) (2 175 000 × 20%) Investment in S Ltd (SFP) Elimination of investment against equity at acquisition	2 175 000 10 000	435 000 1 750 000
J3	Retained earnings – Beginning of year (SCE) Accumulated depreciation (SFP) Additional depreciation for 20.25 due to fair value remeasurement (175 000/5 × 1/12)	2 917	2 917
J4	Non-controlling interests (SCE) Retained earnings – Beginning of year (SCE) Non-controlling interests in additional depreciation for 20.25 (2 917 × 20%)	583	583
J5	Depreciation for 20.26 (P/L) Accumulated depreciation (SFP) Additional depreciation for 20.26 due to fair value remeasurement (175 000/5)	35 000	35 000
J6	Non-controlling interests (SCE) Non-controlling interests for 20.26 (P/L) Non-controlling interests in additional depreciation for 20.26 (35 000 × 20%)	7 000	7 000

Example 9.21	Measurement-period adjustment – Non-controlling interests measured at fair value
---------------------	---

P Ltd acquired an 80% interest in S Ltd on 1 December 20.25 for R1 750 000. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. The net assets (excluding machinery) of S Ltd had a fair value of R1 500 000. At that date, the machinery of S Ltd had a remaining useful life of five years and a carrying amount of R500 000. P Ltd sought an independent appraisal for the machinery owned by S Ltd, which was only finalised during March 20.26. Initially the value of the plant was estimated at R600 000, but the appraisal indicated a fair value of R675 000 (the difference in fair value related to circumstances that existed at acquisition date).

The financial statements of P Ltd for the reporting period ended 31 December 20.25 were issued on 28 February 20.26.

The non-controlling interests at acquisition date are measured at a fair value of R440 000.

P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.

Ignore any tax consequences.

When preparing the consolidated financial statements for the year ended 31 December 20.25, a value of R600 000 will be allocated to the plant.

The **pro forma consolidation journal** entries for 20.25 will be as follows:

		Dr R	Cr R
J1	Machinery (SFP) Equity at acquisition (SCE) Remeasurement of machinery to provisional fair value (600 000 – 500 000)	100 000	100 000
J2	Equity at acquisition (SCE) (1 500 000 + 600 000) Goodwill (SFP) (balancing) Non-controlling interests (SCE) Investment in S Ltd (SFP) Elimination of investment against equity at acquisition	2 100 000 90 000	440 000 1 750 000
J3	Depreciation (P/L) Accumulated depreciation (SFP) Additional depreciation for 20.25 due to fair value remeasurement (100 000/5 × 1/12)	1 667	1 667
J4	Non-controlling interests (SCE) Non-controlling interests (P/L) Non-controlling interests in additional depreciation for 20.25 (1 667 × 20%)	333	333

The provisional amount used for the machinery will be corrected in the 20.26 financial statements by means of a retrospective adjustment, as the amount is finalised within 12 months from the acquisition date.

The pro forma consolidation journal entries for **20.26** will therefore be as follows:

		Dr R	Cr R
J1	Machinery (SFP) Equity at acquisition (SCE) Remeasurement of machinery to final fair value (675 000 – 500 000)	175 000	175 000
J2	Equity at acquisition (SCE) (1 500 000 + 675 000) Goodwill (SFP) (balancing) Non-controlling interests (SCE) Investment in S Ltd (SFP) Elimination of investment against equity at acquisition	2 175 000 15 000	440 000 1 750 000

continued

		Dr R	Cr R
J3	Retained earnings – Beginning of year (SCE) Accumulated depreciation (SFP) Additional depreciation for 20.25 due to fair value remeasurement ($175\,000/5 \times 1/12$)	2 917	2 917
J4	Non-controlling interests (SCE) Retained earnings – Beginning of year (SCE) Non-controlling interests in additional depreciation for 20.25 ($2\,917 \times 20\%$)	583	583
J5	Depreciation for 20.26 (P/L) Accumulated depreciation (SFP) Additional depreciation for 20.26 due to fair value remeasurement ($175\,000/5$)	35 000	35 000
J6	Non-controlling interests (SCE) Non-controlling interests for 20.26 (P/L) Non-controlling interests in additional depreciation for 20.26 ($35\,000 \times 20\%$)	7 000	7 000

**Comment**

The pro forma fair value remeasurement and elimination journal entries (journals 1 and 2) could also have been combined into one journal:

	Dr R	Cr R
1 December 20.25		
Machinery (SFP)	175 000	
Equity at acquisition (SCE) ($1\,500\,000 + 500\,000$)	2 000 000	
Goodwill (SFP) (balancing)	15 000	
Investment in S Ltd (SFP)		1 750 000
Non-controlling interests (SCE)		440 000
Elimination journal entry at acquisition		

Self-assessment question

Question 9.1

P Ltd is a new company listed on the JSE Limited. The company primarily invests in a number of diversified subsidiaries. All the companies in the group have a 30 September reporting period. P Ltd acquired an 87% holding in S Ltd on 1 October 20.21 from X Ltd. From that date, P Ltd had control over S Ltd as per the definition of control in accordance with IFRS 10. The purchase agreement stipulated that the 87% interest in S Ltd must be settled as follows:

- ☐ A cash payment of R12 million was made to X Ltd on 1 October 20.29.
- ☐ An amount of R30 million will be paid to X Ltd on 30 September 20.35.

- ☐ P Ltd transferred land to X Ltd. The land has a fair value of R50 million and a carrying amount of R42 million on 1 October 20.29. The fair value increased to R55 million on 15 October 20.29 when transfer was formally registered with the Deeds Office.
- ☐ An additional amount of R10 million will be paid in cash to X Ltd on 31 March 20.33 if the profits generated by S Ltd during the period 1 October 20.29 to 31 March 20.33, increase by 150% above the current level. The probability of this at 1 October 20.29 is 45%. The fair value of this obligation, taking into account the probability and time value of money, is R3 198 066.
- ☐ P Ltd issued 200 000 call options on its own shares to X Ltd on 1 October 20.29. The options entitle X Ltd to take up 200 000 ordinary shares in P Ltd on 30 September 20.30 at an exercise price of R7 per share. If the share price of P Ltd drops before or on 31 March 20.30, additional options will be issued to X Ltd in order to maintain the original value of the options issued.
- ☐ An amount of R100 000 was paid to an attorney for the valuation of S Ltd's assets. These costs were included in the cash amount of R12 million paid by P Ltd.

The abridged statement of financial position of S Ltd as at 1 October 20.29 was as follows:

Equity

Share capital (10 000 000 shares)	5 000 000
Reserves	55 957 000
Total equity	<u>R60 957 000</u>

The net asset value of S Ltd is considered to be fairly valued with the exception of the following:

- ☐ S Ltd has owner-occupied property, consisting of land and buildings, with the following relevant information on the 1 October 20.29:

	Cost	Carrying amount	Fair value	Residual value
Land	R19 million	R19 million	R25 million	–
Buildings	R32 million	R28 million	R44 million	R36 million

It is the accounting policy of both P Ltd and S Ltd to account for property, plant and equipment using the cost price model in accordance with **IAS 16 Property, Plant and Equipment**.

- ☐ At acquisition S Ltd is facing legal action from Y Ltd due to a deal that went sour. The amount of the claim is R5 million. The legal advisors of S Ltd are of the opinion that there is a 30% chance that the claimant will be successful with its case. After talks with their legal team S Ltd is contemplating taking out insurance to cover the claim. An independent insurer has quoted a once-off premium of R750 000. The SARS will not allow any deductions relating to the claim or the once-off premium.
- ☐ The success of S Ltd is largely due to its workforce. Their staff has been trained by the best to be the best. P Ltd has taken note of this, and it is as a crucial reason for acquiring S Ltd. S Ltd has determined that to replace their current workforce would cost R6 million (P Ltd accept this as the fair value).

- ☐ Another reason why P Ltd was interested in S Ltd is its huge customer database. The attorney determined the fair value of the customer database at R5 million. It can be assumed that customer data bases are frequently exchanged. S Ltd has signed confidentiality agreements with all its customers preventing them from exchanging information with third parties.

Additional information

- ☐ Unless stated otherwise, assume a fair pre-tax market-related rate of 10% per annum, compounded annually.
- ☐ P Ltd elected to measure non-controlling interests at fair value on acquisition date.
- ☐ P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.
- ☐ Assume a tax rate of 27% and a capital gains tax inclusion rate of 80%.
- ☐ The following information relates to P Ltd:

Fair value of P Ltd shares (per share)	
1 October 20.29	R15
31 March 20.30	R14,20
Fair value of call options to X Ltd (per option)	
1 October 20.29	R6
31 March 20.30	R5,30

- ☐ The following information relates to S Ltd:

Fair value of S Ltd shares (per share)	
1 October 20.29	R9

Required

- (a) Prepare the journal entry to account for the acquisition of S Ltd, as required in the separate financial statements of P Ltd on 1 October 20.29, in accordance with **IFRS 3 Business Combinations**.
- (b) Prepare the at acquisition consolidation journal entry that is required on 1 October 20.29, in order to include S Ltd in the consolidated financial statements of the P Ltd Group. Journals should also include applicable items which have no value and deferred tax calculation for applicable items.

Round off to the nearest rand.

Suggested solution 9.1

(a) Journal entry in the separate financial statements of P Ltd

		Dr R	Cr R
J1	1 October 20.29 Investment in S Ltd (SFP) (balancing) Valuation expenses (P/L) Bank (SFP) Liability (SFP) (C1) Land (SFP) Gain on land transferred (P/L) Contingent consideration liability (SFP) Options (SCE) (C2) Recognise the acquisition of S Ltd	83 232 284 100 000	12 000 000 16 934 218 42 000 000 8 000 000 3 198 066 1 200 000



Comment

The consideration transferred may include assets of the acquirer that have carrying amounts that differ from their fair values at the acquisition date. If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values and recognise the resulting gains or losses in profit or loss.

However, sometimes the transferred assets remain within the combined entity after the business combination and the acquirer therefore retains control of them. In this situation, the acquirer shall measure those assets at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss.

(b) Consolidation journal entry in the consolidated financial statements of the P Ltd Group

		Dr R	Cr R
J1	1 October 20.29 Land (SFP) (C3.1) Buildings (SFP) (C3.2) Contingent liability (SFP) Intangible asset (SFP) – Workforce Intangible asset (SFP) – Customer data base Deferred tax (SFP) (C4) Retained earnings/Equity at acquisition (SCE) Remeasurment of assets and liabilities i.t.o IFRS 3	6 000 000 16 000 000 – – 	 750 000 5 400 000 15 850 000
J2	Share capital (SCE) Retained earnings (SCE) (55 957 000 + 15 850 000) Goodwill (SFP) (balancing) Investment in S Ltd (SFP) (Part (a)) Non-controlling interests (SCE) (C5) At acquisition elimination journal of S Ltd	5 000 000 71 807 000 18 125 284	 83 232 284 11 700 000

Calculations**C1 Liability – Deferred settlement**

$FV=30\,000\,000$; $i=10\%$; $n=6$; $Pmt=0$; $PV=16\,934\,218$

C2 Equity instrument – Share options

$200\,000 \times 6 = 1\,200\,000$

C3 Owner-occupied property

	Land	Building
Fair value 1 October 20.29	25 000 000	44 000 000
Carrying amount 1 October 20.29	19 000 000	28 000 000
Fair value remeasurement	R6 000 000	R16 000 000
	(C3.1)	(C3.2)

C4 Deferred tax

	Carrying amount	Tax base	Temporary difference	Deferred tax
Land – Fair value remeasurement	6 000 000	–	6 000 000	(*)1 296 000
Building – Fair value remeasurement				
Carrying amount to cost	4 000 000	–	4 000 000	1 080 000
Cost to residual	4 000 000	–	4 000 000	(*)864 000
Above residual	8 000 000	–	8 000 000	2 160 000
	16 000 000		16 000 000	4 104 000
Contingent liability	750 000	750 000	–	
				R5 400 000

(*) Will be realised at the capital gains tax rate

C5 Non-controlling interests

$10\,000\,000 \times 13\% \times 9 = 11\,700\,000$

10

IFRS 10

Consolidated financial statements

– Control

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Introduction

10.1 Overview of the topic

The objective of **IFRS 10 Consolidated Financial Statements** is to establish principles for the presentation and preparation of consolidated financial statements.

To meet the above objective, the standard:

- ☐ requires a parent entity to present consolidated financial statements;
- ☐ defines the principle of **control**, and establishes control as the basis for consolidation;
- ☐ set out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;
- ☐ sets out the accounting requirements for the preparation of consolidated financial statements; and
- ☐ defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

The presentation and preparation of consolidated financial statements are dealt with in Volume 1, chapter 1 and chapter 3 to 8, respectively. Investment entities will be briefly dealt with under paragraph 10.2 below and the principles of control will be summarised and illustrated in the remainder of this chapter. IFRS 10 contains detailed guidance for the application of the principles of control and should also be consulted.

The definition and principle of control is also important when applying **IFRS 3 Business Combinations**. A business combination is defined in IFRS 3 as a transaction or other event in which an acquirer obtains control of one or more businesses. The business combination definition thus comprises mainly two core aspects, namely “**control**” and “**business**”. Although “**business**” is defined in IFRS 3, control is only addressed in IFRS 10.

10.2 Investment entities

IFRS 10 specifically states that investment entities are excluded from the requirement to prepare consolidated financial statements. Investment entities are defined as an entity that:

- ☐ obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- ☐ commits to its investor(s) that its business purpose is to invest funds solely for capital appreciation, investment income, or both; and
- ☐ measures and evaluates the performance of substantially all of its investments on a fair value basis.

Investment entities also have the following typical characteristics that should be considered when assessing if an entity is an investment entity:

- ☐ the entity has more than one investment;
- ☐ the entity has more than one investor;
- ☐ the entity has investors that are not related parties of the entity; and
- ☐ the entity has ownership interests in the form of equity or similar interests.

If an entity is classified based on the above definition and typical characteristics as an investment entity:

- ☐ the entity is not required to assess control in terms of **IFRS 10**;
- ☐ the entity is not required to apply **IFRS 3 Business Combinations**; and
- ☐ the entity is not required to consolidate its subsidiaries.

Instead the entity will measure all their investments at **fair value through profit or loss** in accordance with **IFRS 9 Financial Instruments**.

If the circumstances and facts indicate that there were changes to one or more of the elements that make up the definition of an investment entity, or to the typical characteristics of an investment entity, the investor should reconsider the investment entity classification. Any change in the status of the investment entity classification shall be accounted for prospectively from the date at which the change in status occurred.

IFRS 12 requires an investment entity to disclose the following:

- ☐ the fact that the entity is classified as an investment entity;
- ☐ significant judgements and assumptions the entity has made in determining that it is an investment entity;
- ☐ if the investment entity does not have one or more of the typical characteristics of an investment entity, it shall disclose its reasons for concluding that it is nevertheless an investment entity;
- ☐ for each unconsolidated subsidiary:
 - the subsidiary's name;
 - the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary; and
 - the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held;
- ☐ the nature and extent of any significant restrictions on the ability of an unconsolidated subsidiary to transfer funds to the investment;
- ☐ any current commitments or intentions to provide financial or other support to an unconsolidated subsidiary;
- ☐ if, during the reporting period, an investment entity or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated subsidiary the entity shall disclose:
 - the type and amount of support provided to each unconsolidated subsidiary; and
 - the reasons for providing the support;
- ☐ the terms of any contractual arrangements that could require the entity or its unconsolidated subsidiaries to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss;
- ☐ if during the reporting period an investment entity or any of its unconsolidated subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated, structured entity that the investment entity did not control, and if that provision of support resulted in the investment entity controlling the structured entity, the investment entity shall disclose an explanation of the relevant factors in reaching the decision to provide that support.

Example 10.1	Investment entities
---------------------	----------------------------

P Ltd was established to manage retirement funds of various public and private sector pension funds. The company has two main investors being the Government Pension Fund and Invest Pension Fund. P Ltd prepares quarterly reports which are sent to investors and used internally to measure performance. These reports typically include information about the return on investment and fair value movements of the investments made by P Ltd. The commission earned by P Ltd is also based on the quarterly reports. P Ltd's investments consist mainly of equity investments of various local companies listed on the JSE Ltd. For one of these equity investments, S Ltd, P Ltd holds a 62% controlling interest.

P Ltd was established to manage retirement funds. P Ltd also uses fair value measurement to gauge their performance and invests in various local companies. P Ltd has more than one investment, more than one investor, it does not appear if the parties are related and P Ltd invests in equity. P Ltd therefore meets the definition of an investment entity.

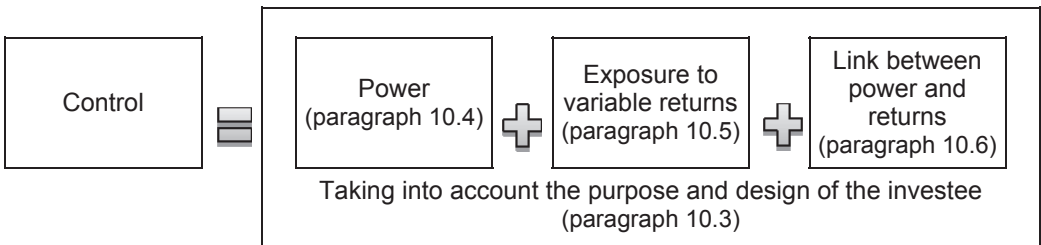
P Ltd shall thus not consolidate S Ltd, but will instead measure the investment in a subsidiary at fair value through profit or loss in accordance with **IFRS 9 Financial Instruments**.

**Comment**

IFRS 10.B85A–.B85W provides detail guidance on the assessment of an investment entity.

Control

In terms of **IFRS 10 Consolidated Financial Statements** an entity that is a parent shall present consolidated financial statements. A parent is defined as an entity that controls one or more entities. Therefore, an investor, regardless of the nature of its involvement with the investee, shall determine whether it is a parent by assessing whether it controls the investee. An investor **controls** an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (IFRS 10 Appendix A). The definition can be illustrated as follows:





Comment

It is important to note that **all three elements** of control must be present in a scenario before control over an investee can be achieved. If any one of the elements are not satisfied, the control assessment can be ceased because control is not present.

An investor should continuously assess if it still controls an investee. If the circumstances and facts indicate that there were changes to one or more of the three elements of control, as indicated above, the investor should consider if control over an investee was perhaps obtained or lost.



Comment

It may even happen that an investor gains or loses power over an investee without any action taken by the investor. For example, an investor can gain power over an investee because decision-making rights held by another party or parties that previously prevented the investor from controlling an investee have lapsed.

Two or more investors cannot jointly be regarded as the parent of an investee. If two or more investors collectively control (act together to direct the relevant activities) an investee, none of the investors individually controls the investee. Each investor would account for its interest in the investee in accordance with other relevant IFRSs, such as **IFRS 11 Joint Arrangements**, **IAS 28 Investments in Associates and Joint Ventures** or **IFRS 9 Financial Instruments**.

10.3 Purpose and design of the investee

The purpose and design of the investee impacts the determination of control. Although the purpose and design of the investee is not an element of the control definition, it is the primary consideration when accessing control. An investor shall consider the purpose and design of the investee in order to identify:

- ☐ the relevant activities;
- ☐ how decisions about the relevant activities are made;
- ☐ who has the current ability to direct those activities; and
- ☐ who receives returns from those activities.



Comment

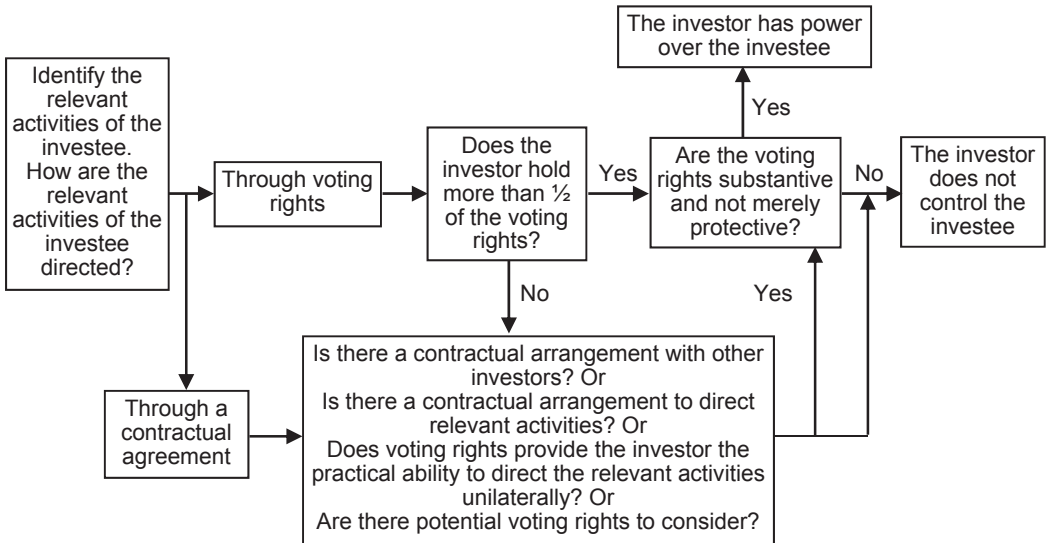
The assessment may be straightforward, for example if an investee, in the absence of additional arrangements that alter decision-making, is controlled by means of equity instruments for instance shares. The equity instruments give the holder proportionate voting rights. The party who is able to exercise voting rights sufficient to determine the investee's operating and financing policies will control the investee and should therefore prepare consolidated financial statements. In other cases the assessment may be more complex and the other elements of control should also be considered in assessing control.

Example 10.2	Purpose and design of the investee
---------------------	---

S Ltd was incorporated exclusively to manage the debtors of a commercial bank, P Ltd. The only assets of S Ltd are the debtors. When the purpose and design of S Ltd are considered, it is determined that the only relevant activity is managing the debtors upon default. The party that has the ability to manage the defaulting debtors has power over S Ltd, irrespective of whether any of the debtors are currently recoverable or not.

10.4 Power of an investee

The assessment of power can be explained by the following decision tree:



An investor has power over an investee when the investor has **existing rights** that give it the current ability to direct the **relevant activities** (activities that significantly affect the investee's returns) of the investee.

1 Existing rights

Power arises from rights. The rights that may give an investor power can differ between investees. Rights that, either individually or in combination, can give an investor power include:

- ☐ voting rights or potential voting rights of an investee;
- ☐ rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;
- ☐ rights to appoint or remove another entity that directs the relevant activities;
- ☐ rights to direct the investee to enter into, or veto any changes to transactions for the benefit of the investor; and
- ☐ other rights for instance decision-making rights specified in a management contract that give the holder the ability to direct the relevant activities.

In the absence of additional arrangements that alter decision-making, control is simply determined by voting rights. The party that is able to exercise voting rights (power) sufficient to determine the investee's operating and financial policies (relevant activities), controls the investee.

**Comment**

Refer to chapter 1 (Volume 1) for examples of different group structures.

For the purpose of assessing power, an investor shall only consider **substantive rights** and rights that are not **protective** (refer to point 3 and 4 respectively, below).

2 Relevant activities

It is important to note that the investor should have control over the relevant activities of the investee. IFRS 10 defines **relevant activities**, as activities of the investee that **significantly** affect the investee's returns. This implies that the investor, who ultimately can direct the relevant activities, would have power over the investee. Activities that, depending on the circumstances, can be relevant activities include:

- ☐ selling and purchasing of goods or services;
- ☐ managing financial assets during their life;
- ☐ selecting, acquiring or disposing of assets;
- ☐ researching and developing new products or processes; and
- ☐ determining a funding structure or obtaining funding.

**Comment**

Refer to example 10.4 and 10.5 for examples of relevant activities.

3 Substantive rights

An investor's **rights** over an investee's relevant activities should be considered when assessing control. Only substantive rights may lead to control. A right is substantive when the holder of the right has the practical ability to exercise that right relating to an investee. The investor should also consider the nature of the investee's relationship with other parties when determining if the rights are substantive. Factors that could impact if a right is substantive or not include:

- ☐ Whether there are any barriers that prevent the holder from exercising the rights, for example, financial penalties that would prevent or deter the holder from exercising its rights.
- ☐ When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive.
- ☐ Whether the party or parties that hold the rights would benefit from the exercise of those rights, for example, the holder of potential voting rights in an investee shall consider the exercise or conversion price of the instrument.

To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

**Comment**

Potential voting rights (refer below) are also only considered when those rights are **substantive**.

Example 10.3**Substantive rights**

On 1 April 20.26 P Ltd acquired an option to acquire the majority of shares in S Ltd. The option will be settled on 25 April 20.26. In terms of S Ltd's memorandum of incorporation, policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments. The next scheduled shareholders' meeting is in three months. Shareholders that individually or collectively hold at least 5% of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days.

P Ltd is considered to have the practical ability to settle the option. The option will only be settled in 25 days. However, the existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the option will have been settled. There are also no barriers preventing P Ltd from settling the option.

On 1 April 20.26 P Ltd's option is a substantive right that gives P Ltd the current ability to direct the relevant activities even before the option is settled. Therefore, P Ltd has rights that are essentially equivalent to the majority shareholder in S Ltd.

**Comment**

If however the exercise price of the option is substantively more than the current share price of S Ltd, the option would potentially not be a substantive right as P Ltd would not benefit from exercising the right.

4 Protective rights

Substantive rights exercisable by other parties can prevent an investor from controlling the investee to which those rights relate. As long as the rights are not merely protective, substantive rights held by other parties may prevent the investor from controlling the investee even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

IFRS 10 defines protective rights as rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Examples of protective rights include:

- ☐ a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender;
- ☐ the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments;
- ☐ the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

Example 10.4	Protective rights
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P Ltd holds a 55% interest in S Ltd and another shareholder B Ltd holds the remaining 45%. The shareholders agreement between P Ltd and B Ltd states that B Ltd is responsible for the day to day running of S Ltd and approval from P Ltd will only be required if S Ltd required additional funding. The terms of the shareholders agreement can only be changed with the approval of both parties.

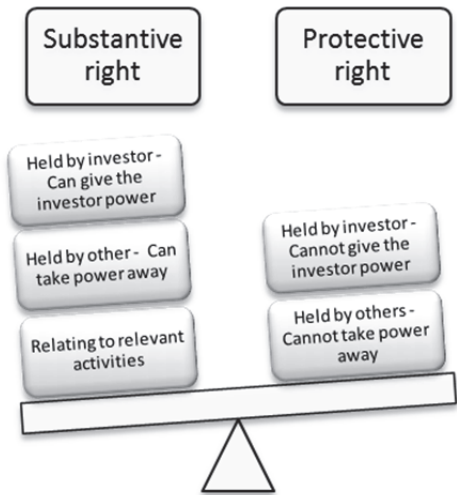
P Ltd holds more than half of the voting rights of S Ltd. P Ltd has the right to restrict S Ltd from undertaking activities that could significantly change the credit risk (through additional funding) of S Ltd to the detriment of P Ltd. Another entity, B Ltd, has existing rights that provide them with the right to direct the relevant activities of S Ltd. P Ltd can also not change the shareholders agreement without the approval of B Ltd. Thus although P Ltd holds the majority of the voting rights of S Ltd, it only holds protective rights and does not have power over S Ltd.



Comment

Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to whom those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

The difference between substantive rights and protective rights is important and often confused. The difference can be summarised as follows:



5 Franchises

A franchise agreement for which the investee is the franchisee often gives the franchisor rights that are designed to protect the franchise brand. Franchise agreements typically also give franchisors some decision-making rights with respect to the operations of the franchisee.

However, it is necessary to distinguish between having the current ability to make decisions that significantly affect the franchisee's returns and having the ability to make

decisions that protect the franchise brand. The franchisor does not have power over the franchisee if other parties have existing rights that give them the current ability to direct the relevant activities of the franchisee. For example, the shareholders of an investee will have power over the business (relevant activities) of the franchisee and run the business to maximise profits. In doing so, the franchisee will have to follow some rules meant to protect the franchise brand in terms of the franchise agreement.

6 Power through majority of voting rights

An investor has power over an investee if the following requirements are met:

- ☐ the investor holds **more than half of the voting rights** of an investee;
- ☐ the voting rights are **substantive**; and
- ☐ voting rights **direct the relevant activities** (refer to paragraph 10.4, point 2) of the investee or the voting right may appoint the majority of the executive management of the investee.

Example 10.5

Majority of voting rights without power

S Ltd was incorporated by the local municipality to install prepaid water and electricity meters at residential properties. P Ltd, a manufacturer of prepaid water and electricity meters acquired a 60% interest in S Ltd from the municipality. The **shareholders agreement** between the municipality and P Ltd stipulates the following terms:

- ☐ Each share entitles the holder to one vote.
- ☐ The board of directors will comprise of two nominees of P Ltd and two nominees of the municipality.
- ☐ S Ltd will purchase all the meters from P Ltd at a fixed price. The fixed price can only be changed with the approval of the municipality.
- ☐ The municipality will determine the selling and installation price of the meters.

In general P Ltd will be regarded as having power over S Ltd, as P Ltd own 60% (each share entitle the holder to one vote) of the total voting rights, which constitutes the majority of the voting rights. However, although P Ltd owns the majority of the voting rights, the shareholders agreement stipulate the municipality will determine the selling and installation price of the prepaid meters and will have to approve any change into the input cost of S Ltd's inventory. These activities are deemed to be the relevant activities, as they significantly affect the returns of S Ltd; therefore, the relevant activities are directed by the municipality through the shareholders agreement. P Ltd does not have the power of S Ltd as it does not have the power to direct the relevant activities that significantly affects the returns of S Ltd.



Comment

Power over the investee can therefore not be automatically assumed if the investor merely owns more than 50% of the shares in an investee. Other factors should also be considered to determine control over an investee.

7 Power without a majority of voting rights (de facto power)

An investor can have power with less than a majority of the voting rights of an investee, for example, through:

- ☐ a contractual arrangement between the investor and other vote holders, for example a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities;
- ☐ rights arising from other contractual arrangements, for example a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct the relevant activities of the investees;
- ☐ voting rights, if the voting rights provides the investor the practical ability to direct the relevant activities unilaterally; or
- ☐ potential voting rights (refer to point 8 below); or
- ☐ a combination of the above.

When assessing whether an investor’s voting rights are sufficient to give it power, all facts and circumstances should be considered. The size of the investor’s holding of voting rights relative to the size and dispersion of holdings of the other vote holders is important, as the more voting rights an investor holds, the more likely the investor is to have existing rights enabling it to direct relevant activities. An investor is also more likely to have the current ability to direct relevant activities, where a lot of parties are needed to act together to outvote the investor.

Example 10.6	Power without a majority of voting rights
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S Ltd has 1 million shares in issue and each ordinary share entitles the holder to one vote at shareholders’ meetings. S Ltd’s operating and financial policies are determined by the company’s Board of Directors. All the directors of S Ltd are appointed by the shareholders at annual general meetings by simple majority vote.

Details of voting rights represented at the annual general meetings of S Ltd’s shareholders are as follows:

	Annual general meeting held on		
	31 May 20.22	31 May 20.21	31 May 20.20
Voting rights represented, in person or by proxy	90%	92%	87%

On 1 January 20.23 P Ltd acquired 49% of the shares of S Ltd in the open market. The remaining shares were widely held by shareholders holding less than 1% each of the share capital.

The relevant activities of S Ltd are the operational and financial activities of the company. Changes through the operational and financial policies will affect the investee’s returns. From the information provided it is evident that the board of directors make the operating and financial decisions and in turn they direct the relevant activities of S Ltd. Directors are appointed by the shareholders by a simple majority vote on shareholder meetings. Therefore, a majority shareholder vote (>50%) at meetings would enable the appointment of the directors and implicitly gain power over the relevant activities of S Ltd. However, no single investor holds the majority of the voting rights.

Nonetheless, P Ltd's shareholding of 49% is significant in relation to the other shareholders and based on past attendance of the shareholders meetings, P Ltd has significantly more voting rights than any other vote holder.

Attendance at shareholders' meetings reveals that during the last three years, on average no more than 90% of shareholders were present at the shareholder meetings. Therefore, any shareholder who holds more than 45% (50% of the 90% voting rights at a shareholders' meeting) of the voting rights would be considered to have the majority vote. As P Ltd acquired 49% of the shares of S Ltd, P Ltd will be deemed to have power over S Ltd even without holding the majority of the voting rights.



Comment

IFRS 10.B39–.B46 provides detail guidance on assessing power when the investor does not own a majority of voting rights.

8 Potential voting rights

Potential voting rights should also be considered in assessing power, if the rights are substantive (see point 3 above). This will include potential voting rights of the investee held by the investor or other parties. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments, options, or forward contracts.

When considering potential voting rights, an investor shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement with the investee. This includes an assessment of the various terms and conditions of the instrument as well as the investor's apparent expectations, motives and reasons for agreeing to those terms and conditions.

Example 10.7

Potential voting rights

P Ltd owns 42% of the issued share capital of S Ltd. S Ltd issued share capital consist of 1 000 shares and each share qualifies for one vote. P Ltd also holds 400 convertible debentures in S Ltd. The convertible debentures are convertible at any time at the discretion of the holder. Two debentures are convertible into one share and the debentures are currently convertible.

If the debentures are converted S Ltd's issued share capital will increase to 1 200 shares and P Ltd's investment in S Ltd will increase to 620 shares (420 previously owned shares and 200 converted shares). P Ltd will therefore own 52% (620/1200) of S Ltd.

For that reason, P Ltd has power over S Ltd even though the convertible debentures have not yet been converted as P Ltd's potential voting power of 52% constitutes more than half of the total voting power (assuming there are no other contractual agreements or rights that dictate otherwise).



Comment

When consolidating S Ltd, the present ownership interest should be used to allocate the equity of S Ltd between the controlling and non-controlling interests, thus 42% to P Ltd and 58% to the non-controlling shareholders.

10.5 Exposure to variable returns from an investee

The second component of the definition of control is that an investor should be exposed, or have rights to **variable returns** from its involvement with the investee. An investor is exposed to variable (not fixed) returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. Variable returns can be only positive, only negative or both positive and negative. Variable returns can also be financial returns only, non-financial returns only, or both financial and non-financial returns.

Examples of returns include:

- ☐ dividends, other distributions of economic benefits from an investee and changes in the value of the investor's investment in that investee;
- ☐ remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee;
- ☐ returns that are not available to other interest holders, for example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve cost savings, sourcing scarce products, limiting some operations or assets, or to enhance the value of the investor's other assets.

	Comment Although only one investor can control an investee, more than one party can share in the returns of an investee, for example, holders of non-controlling interests can share in the profits or distributions of an investee. The investor who controls the investee has the power to influence the performance of the investee (through its decisions regarding the relevant activities) which will result in variable returns to the controlling investor and other investors.
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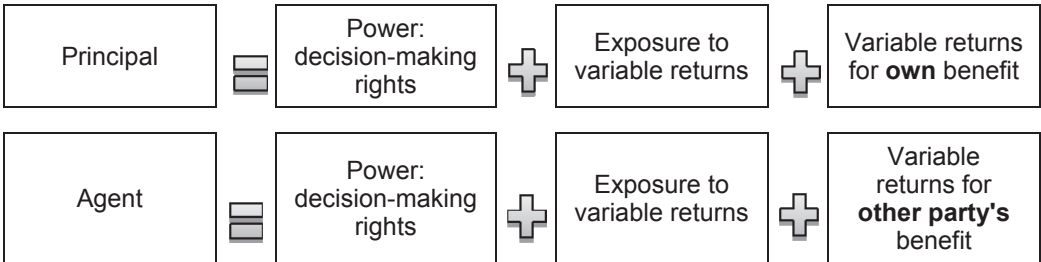
10.6 Link between power and variable returns

An investor controls an investee if the investor not only has power over the investee, and exposure to variable returns from its involvement with the investee, but also has the ability to use its power to **use** its power to **affect** the investor's returns from its involvement with the investee. There must be a connection between the power and variable returns.

Agent classification

An investor may use its power over the investee itself, or it may appoint an agent to exercise its power on its behalf. When an investor with decision-making rights assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An **agent** is a party that acts on behalf of and for the benefit of another party namely

the principal. The difference between an agent and a principal can be illustrated as follows:



Important to note is that a decision-maker is not regarded as an agent simply because other parties can benefit from the decisions that it makes. An agent does not control the investee when it exercises its decision-making authority and therefore will not have to present consolidated financial statements. Control still lies with the principal on whose behalf the agent is acting.

The agent/principal assessment is crucial for investment managers who make investment decisions on behalf of investors in exchange for a fee. A decision-maker should consider their relationship with the investee and other parties involved with the investee in determining whether the decision-maker is acting in the capacity of an agent. The following factors should all be considered in the assessment:

- ☐ the scope of the decision-maker's authority over the investee;
- ☐ the rights held by other parties;
- ☐ the remuneration to which the decision-maker is entitled; and
- ☐ the decision-maker's exposure to variability of returns from other interests that it holds in the investee.



Comment

IFRS 10 provides detail additional guidance on the factors that should be considered in accessing agent/principal relationship (IFRS 10.B60–.B72).

Example 10.8

Investor acting as agent or principal

P Ltd, a fund manager markets and manages an investment fund that provides investment opportunities to a number of investors. P Ltd (decision-maker) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, P Ltd has wide decision-making discretion. P Ltd also receives a market-based fee for its services equal to 1% of the assets under its management and 20% of all the fund's profits if a specified profit level is achieved. The fees are proportionate to the services provided. P Ltd can also be dismissed by investors with a majority vote.

P Ltd must make decisions in the best interests of all investors. P Ltd is paid fixed and performance-related fees that are proportionate to the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors (the fund manager's fee is based on the fund's performance). Although P Ltd does have decision-making powers over the fund, it does so under the governing agreement as set up by the investors. P Ltd can also be removed as decision-maker by

the investors if they are not satisfied with the fund's performance. P Ltd is acting as an agent and therefore does not control the fund.

If P Ltd also has a significant investment in the fund, it can be argued that P Ltd is exposed to variable returns that may arise from the activities of the fund. Together with P Ltd's decision-making authority it may be concluded that P Ltd does control the fund.

10.7 Unconsolidated structured entities

A **structured entity** is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when the voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements (IFRS12.B21). An **unconsolidated structured entity** would therefore be a structured entity that is not controlled (nor consolidated) by the investor. Examples of structured entities include securitisation vehicles, asset-backed financings and some investment funds.

Entities that have an interest in an unconsolidated structured entity shall disclose information that enables the users of the financial statements to:

- ☐ understand the nature and extent of its interest in the unconsolidated structured entity; and
- ☐ evaluate the nature of, and changes, in the risks associated with its interest in the unconsolidated structured entity.

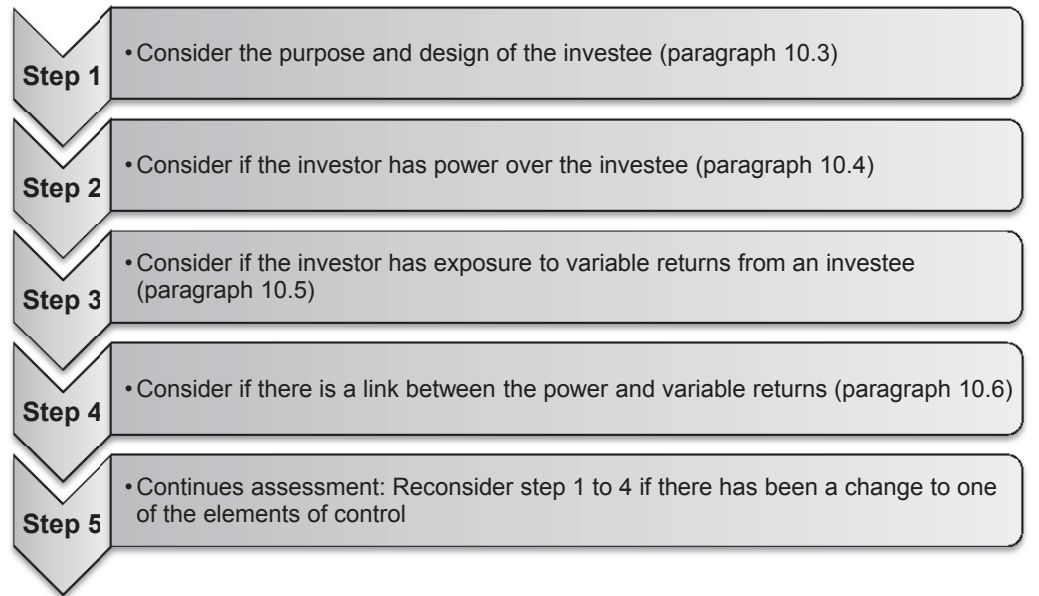


Comment

Refer to IFRS 12.B21–.B26 for a detailed explanation of unconsolidated structured entities as well as the disclosure requirements.

10.8 Summary of control assessment

The control assessment can be illustrated as a follows:



Self-assessment question

Question 10.1

Beta Ltd grows coffee beans and supplies coffee beans exclusively to Alpha Ltd. Alpha Ltd acquired a 50% shareholding (each share entitles a shareholder to one vote) in Beta Ltd from Mr B, the sole shareholder.

Mr B and Alpha Ltd signed the purchase agreement on 1 January 20.23. In terms of the purchase agreement, Alpha Ltd will have the right to appoint staff and key management personnel of Beta Ltd.

On the date of acquisition, Beta Ltd's equity consisted of the following:

Ordinary share capital	R150 000
Convertible non-cumulative preference shares	R30 000
Retained earnings	R340 000

The unlisted convertible preference shares were issued on 1 August 20.10 and are mandatorily convertible into 50 000 Beta Ltd ordinary shares on 31 July 20.24. The preference shares are not convertible prior to that date. The holders of the preference shares do not have voting rights except on matters that directly affect their rights. The preference shares had a fair value of R1,2 million on 30 September 20.23. The company's founder, Mr B, has held the preference shares since 1 August 20.10.

Required

Discuss, with reasons, whether Beta Ltd is a subsidiary of Alpha Ltd as at 30 September 20.23.

Suggested solution 10.1

A subsidiary is an entity that is controlled by another entity (IFRS 10.App A).

Alpha Ltd, as the investor, has to determine whether it is a parent by assessing whether it **controls** the investee, Beta Ltd (IFRS 10.5).

An investor controls an investee when the investor is exposed, or has rights, to **variable returns** from its involvement with the investee and has the **ability to affect those returns** through its **power** over the investee.

Power

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities (IFRS 10.10).

Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

- (a) rights in the form of voting rights (or potential voting rights of an investee); and
- (b) rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities (IFRS 10.B15).

Potential voting rights:

When assessing whether Alpha Ltd's voting rights are sufficient to give it power over Beta Ltd, all facts and circumstances should be considered, including **potential voting**

rights held by others. For a potential voting right to be substantive, the holder must have the practical ability to exercise that right.

At 30 September 20.23 Mr B held potential voting rights in the form of the convertible preference shares. However, these were not substantive on 30 September 20.23 as it is not currently exercisable and therefore the convertible preference shares can be ignored.

Protective voting rights:

In evaluating whether rights give an investor power over an investee, the investor shall also assess whether its rights, and rights held by others, are **protective rights** (IFRS 10.B26).

Because protective rights are designed to protect the interests of their holder without giving that party power over the investee, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

Mr B's preference shares are protective rights as he can only vote on matters that directly affect his rights as a preference shareholder and are therefore the preference shares are not included in the assessment of control over Beta Ltd.

Rights in the form of voting rights:

Alpha Ltd owns 50% of the voting rights of Beta Ltd, which does not constitute the majority voting rights. Therefore, Alpha Ltd does not have power over Beta Ltd based on its voting rights alone.

Rights to appoint members of an investee's key management personnel:

An investor can have power even if it holds less than a majority of the voting rights of an investee through rights arising from other contractual arrangements (IFRS 10.B38).

Based on the purchase agreement, Alpha Ltd has a contractual right to appoint key management personnel.

In light of all of the above, **Alpha Ltd does have power over Beta Ltd.**

Exposure to variable returns

Alpha Ltd has exposure to variable returns by means of the dividends received from the shares owned in Beta Ltd.

Link between power and returns

Alpha Ltd has existing rights (voting rights and rights to appoint key management personnel) through which it is exposed to variable returns (dividends).

Conclusion

The voting rights and contractual agreement, together with the exposure to variable returns and the ability to affect the amount of the returns, results in Alpha Ltd having control over Beta Ltd. Beta Ltd is a subsidiary of Alpha Ltd.

11

Investments in associates and joint ventures

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Accounting for investments in associates in the consolidated financial statements of the investor

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INVESTMENTS IN ASSOCIATES (IAS 28)

Definitions Associate An entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. Equity method Investment initially recognised at cost and adjusted thereafter for the since acquisition change in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee. The other comprehensive income of the investor includes the investor's share of the other comprehensive income of the investee. Significant influence The power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Presume significant influence if investor holds 20% or more of the voting power. Evidenced in the following ways: ☐ Representation on board of directors; ☐ Participation in policy-making processes; ☐ Material transactions between parties; ☐ Interchange of managerial personnel; ☐ Provision of essential technical information. Consider potential voting rights, held by investor and by other entities, that are currently exercisable or convertible.	Accounting treatment Equity method = Cost + Changes in equity since acquisition Cost ☐ Recognised initially at cost. ☐ Goodwill part of cost of investment. ☐ Consider effect of revaluations or fair value adjustments. ☐ Recognise excess in profit or loss. Changes in equity ☐ Recognise share of profit of associate, adjust: • depreciation or amortisation; • cumulative preference dividends; • intragroup profits and losses. ☐ Recognise share of other comprehensive income of associate. ☐ Consider recognition of impairment loss. ☐ Share of losses of associate: • carrying amount of the investment limited to Rnil; • include other long-term interests that will not be settled in foreseeable future; • recognise subsequent profits only after they exceed unrecognised losses.
Other issues ☐ Accounting policies – use uniform policies. ☐ Reporting dates – if different: • associate prepares financial statements at investor's reporting date or • if impracticable, use available financial statements, adjusted for significant transactions (not more than 3 months' difference). ☐ Discontinue equity method – if no longer significant influence: • measure retained investment at fair value; recognise profit or loss; • account for investment in terms of IFRS 9.	Separate financial statements An investment in an associate should be accounted for as follows: ☐ Account for investment at cost; or ☐ In terms of IFRS 9.

Introduction

11.1 Background

IAS 28 Investments in associates and joint ventures (issued May 2011) prescribes the accounting treatment for associates as well as joint ventures.



Comment

The examples in this chapter refer only to **associates**, but they would be equally applicable if the investee was a **joint venture**, since the equity method is applied identically to associates and joint ventures.

An **associate** is an entity in which the investor has significant influence.

From the above definition of an associate, it is clear that significant influence is an important concept for the identification of an associate. IAS 28.4 defines **significant influence** as the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control of those policies.

11.2 Significant influence

If an investor holds, directly or indirectly, through subsidiaries or joint ventures, 20% or more of the voting power of the investee, it is presumed that the investor does have significant influence unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly, through subsidiaries or joint ventures, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

The existence of significant influence is usually evidenced in one or more of the following ways:

- ☐ representation on the board of directors or equivalent governing body of the investee;
- ☐ participation in policy-making processes, including participation in decisions about dividends or other distributions;
- ☐ material transactions between the investor and the investee;
- ☐ interchange of managerial personnel;
- ☐ provision of essential technical information.

Potential voting rights

An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares that have the potential, if exercised or converted, to give the entity additional voting power or reduce another party's voting power over the financial and operating policies of another entity, and should thus be considered in establishing whether an investor has control or significant influence over an investee (this is called potential voting rights).

All presently exercisable or presently convertible instruments held by the investor or other shareholders are taken into account when assessing whether significant influence exists. The combined interests of the parent and the subsidiaries are considered in assessing significant influence. However, the interests that joint ventures and

associates in the group hold are not taken into account. Potential voting rights that are exercisable or convertible only at a future date or only upon the occurrence of a future event are also not brought into the assessment. The facts and circumstances surrounding the potential voting rights instruments should be considered in the assessment. However, the intention of management and the financial capability to exercise or convert are not taken into consideration (IAS 28.7–8).



Comment

P Ltd holds 15% of the issued ordinary share capital of A Ltd, but also has an option to acquire a further 10% of A Ltd's ordinary share capital. As P Ltd potentially owns 25% of the voting rights, it is assumed that P Ltd has significant influence over A Ltd, provided that the option is presently exercisable, resulting in A Ltd being an associate of P Ltd. However, when A Ltd's results, assets and liabilities are equity accounted for, only the 15% existing interest will be taken into account and not the potential interest of 25%.

Instruments containing potential voting rights are accounted for as financial instruments in terms of **IFRS 9 Financial Instruments**.

Accounting for investments in associates in the separate financial statements of the investor

An investment in an associate that is included in the separate financial statements of an investor should be accounted for in accordance with IAS 27.10:

- ☐ carried at cost; or
- ☐ accounted for in accordance with **IFRS 9 Financial Instruments**.

When an investment in an associate, or a portion thereof, meets the criteria to be classified as held for sale, it will be accounted for in accordance with **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations**. Any retained portion that has not been classified as held for sale, will be equity accounted for. After disposal any retained portion will be accounted for in accordance with **IFRS 9 Financial Instruments**, unless the retained interest continues to be an associate, in which case it will still be equity accounted for.

An investor that has investments in associates may not issue consolidated financial statements because it does not have subsidiaries. It is appropriate that such an investor provide the same information about its investments in associates as those enterprises that issue consolidated financial statements.

Accounting for investments in associates in the consolidated financial statements of the investor

11.3 Equity method

An investment in an associate must be accounted for in accordance with the equity method in the consolidated financial statements, except when (IAS 28.17):

- ☐ The exception in IFRS 10 allowing a parent that also has an investment in an associate not to prepare consolidated financial statements, applies; or

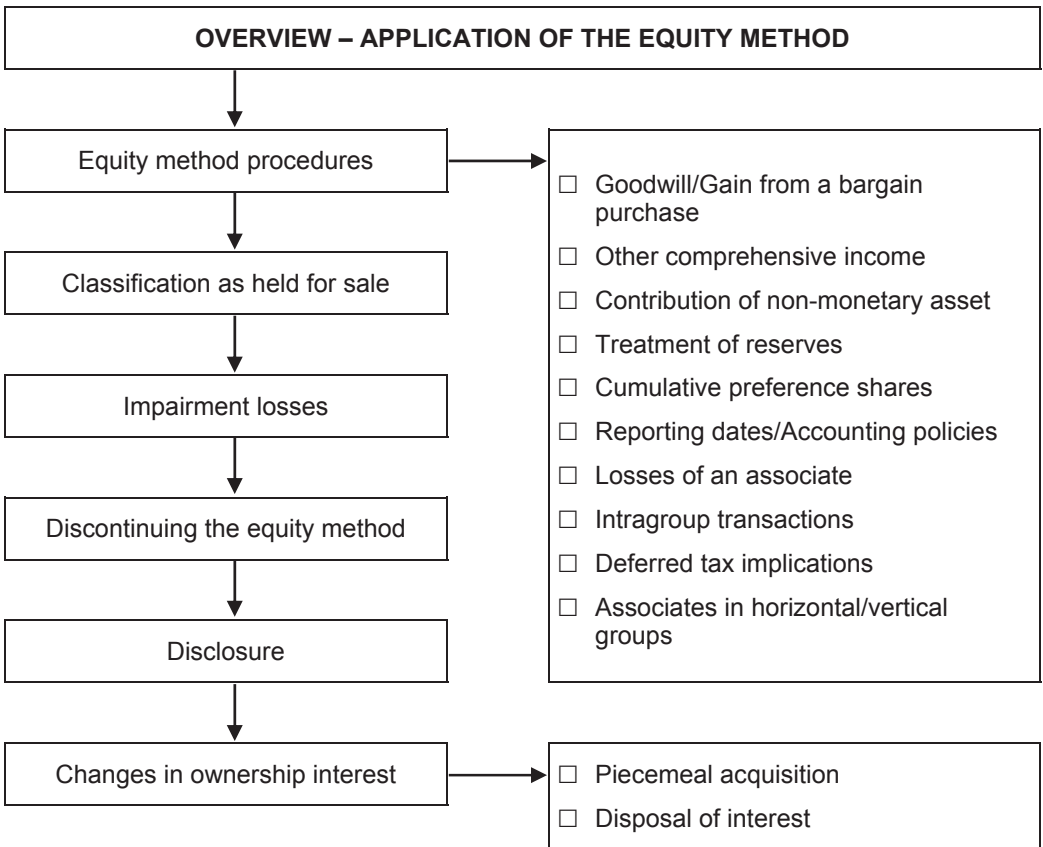
- ☐ All four conditions apply, namely:
 - the investor is a wholly-owned subsidiary of another entity, **or** the investor is a partially-owned subsidiary of another entity and the non-controlling shareholders have no objection against not applying the equity method; **and**
 - the debt and equity instruments of the investor are not traded in a public market; **and**
 - the investor is not in the process of filing its financial statements with a securities commission in order to issue the instruments in a public market; **and**
 - the ultimate or any intermediate parent of the investor prepares consolidated financial statements.
- ☐ If the investment in an associate is held directly or indirectly by a venture capital organisation, a mutual fund, a unit trust or similar entity, the entity may elect to measure the investment at fair value through profit or loss in accordance with **IFRS 9 Financial Instruments**. When the entity has an investment in an associate, a portion of which is held by a venture capital organisation, mutual fund, unit trust or similar entity, this treatment still applies, regardless of whether this entity exercises significant influence over that portion of the investment. If the entity makes this election, the equity method must still be applied by the entity to the remaining portion of the investment not held by a venture capital organisation or similar entity.

According to the **equity method** the investment is initially recorded at cost and after the date of acquisition, increases or decreases are recorded by including the following:

- ☐ the proportionate share of the profit or loss of the investor in the investee after the date of acquisition;
- ☐ distributions received from the investee;
- ☐ the portion of prior year adjustments in the investee since the date of acquisition; and
- ☐ adjustments to the carrying amount due to changes to the proportionate interest of the entity in the investee, flowing from changes to the equity interest of the investee not included in profit or loss – such as the revaluation of property, plant and equipment after the acquisition date, which is recognised in other comprehensive income (IAS 28.10).

The equity method therefore involves the inclusion of only the investment in the associate in the consolidated statement of financial position and only the investor's share of profit and other comprehensive income in the consolidated statement of profit or loss and other comprehensive income. The associate's individual assets, liabilities, income and expenses are not separately included in the consolidated financial statements.

Application of the equity method



11.4 Equity method procedures

An investment in an associate is accounted for under the equity method from the date on which it falls within the definition of an associate. The basic principles and procedures that apply in the preparation of consolidated financial statements also apply in the application of the equity method. In particular, in the application of the equity method:

- ☐ an owners' equity analysis is used as basic calculation;
- ☐ where necessary, individual assets and liabilities of the associate are revalued on the acquisition date;
- ☐ the excess of the cost of the investment over the investor's share in the fair value of the net assets of the associate on the acquisition date is recognised as goodwill. It is however not recognised as a separate asset, but is rather reflected in the cost of the investment. Goodwill is therefore effectively included in the carrying amount of the investment;
- ☐ the excess of the investor's share in the fair value of the net assets of the associate over the cost of the investment on the acquisition date is recognised as a gain from a bargain purchase. This is done by taking this gain from a bargain purchase into

account in calculating the share of profit of associate in the period in which the investment is acquired; and

- ☐ unrealised profits or losses on intragroup transactions are eliminated.

1 Goodwill and gain from a bargain purchase on acquisition

Where the purchase price of the shares in an associate exceeds the portion of the identifiable net assets acquired at fair value, and this is not attributable to a particular asset(s), it is recorded as goodwill in accordance with **IFRS 3 Business Combinations**. Conversely, if the portion of identifiable net assets at fair value exceeds the purchase price of shares in the associate, a gain from a bargain purchase at acquisition will be recognised.

Goodwill that relates to an associate is included in the carrying amount of the investment, and is not amortised. As the goodwill is an integral part of the investment, it cannot be recognised separately, nor assessed separately for the purposes of recognising impairment. Instead, the entire carrying amount of the investment should be tested, if there are indications of impairment.

A **gain from a bargain purchase** on acquisition is recognised in the profit or loss section of the statement of profit or loss and other comprehensive income as part of the share of profit from the associate. The initial investment is increased by the gain from a bargain purchase at acquisition to equal the entity's share of the investee's net asset value on the date of acquisition.

Fair value adjustments at acquisition

All the identifiable assets and liabilities of an associate should be measured at fair value at the date of acquisition (similar to the acquisition of a subsidiary). If the fair values differ from the carrying amounts, fair value adjustments will have to be made. These fair value adjustments affect the carrying amount of assets and liabilities at the acquisition date and consequentially the amount of goodwill (or gain from a bargain purchase) recognised.

When fair value adjustments are recognised at acquisition date, the investee's profits after acquisition date may need to be adjusted, for example, additional depreciation may need to be recognised or a profit on the sale of an asset may need to be adjusted.

2 Other comprehensive income

Not all changes in equity of an associate or joint venture are recognised in profit or loss. Some changes, for example revaluations of property, plant and equipment, as well as fair value adjustments on financial assets subsequently measured at fair value through other comprehensive income, are recognised in other comprehensive income. The entity must recognise its share of these changes in other comprehensive income in its own statement of profit or loss and other comprehensive income (to the extent that it has not been recognised at date of acquisition). They must be presented in the line-item **share of other comprehensive income of associate** in the consolidated statement of profit or loss and other comprehensive income (IAS 28.27).

3 Contribution of a non-monetary asset

When an investor contributes a non-monetary asset to an associate in exchange for an equity interest in that entity, the profit or loss from this contribution is recognised in the investor's financial statements only to the extent of the other investors' interests in the

associate. However, if the contribution lacks commercial substance and no other assets have been received, no profit or loss is recognised (IAS 28.30).

When an investor receives, in exchange for its own non-monetary asset, a monetary or dissimilar non-monetary asset over and above the equity interest in the associate, the entity will recognise in full in profit or loss the portion of the gain or loss on the non-monetary contribution relating to those assets (IAS 28.31).

Example 11.1a	Application of the equity method
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STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
Profit	188 000	100 000
Dividends received from A Ltd	12 000	–
Profit before tax	200 000	100 000
Income tax expense	(94 000)	(50 000)
PROFIT FOR THE YEAR	106 000	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R106 000	R50 000
Total comprehensive income attributable to:		
Owners of the parent	91 000	50 000
Non-controlling interests	15 000	–
	R106 000	R50 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	79 000	70 000
Changes in equity for 20.27		
Dividends	(50 000)	(30 000)
Total comprehensive income for the year:		
Profit for the year	91 000	50 000
Balance at 31 December 20.27	R120 000	R90 000

Additional information

- 1 On 1 January 20.22, P Ltd acquired a 40% equity interest in A Ltd for R84 000. Since the acquisition date, P Ltd has exercised significant influence over the financial and operating decisions of A Ltd. At the date of the acquisition of the 40% equity interest in A Ltd, A Ltd had share capital of R195 000. At that stage, the reserves of A Ltd consisted of retained earnings of R15 000.
- 2 In the above draft consolidated statement of profit or loss and other comprehensive income and draft consolidated statements of changes in equity, the results of A Ltd are accounted for according to the cost method.
- 3 Ignore taxation.

Solution 11.1a

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Profit	188 000
Share of profit of associate	20 000
Profit before tax	208 000
Income tax expense (P)	(94 000)
PROFIT FOR THE YEAR	114 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R114 000
Total comprehensive income attributable to:	
Owners of the parent	99 000
Non-controlling interests	15 000
	R114 000

P LTD GROUP EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27	
	Retained earnings
Balance at 1 January 20.27 (79 000(P) + 22 000(A))	101 000
Changes in equity for 20.27	
Dividends	(50 000)
Total comprehensive income for the year:	
Profit for the year	99 000
Balance at 31 December 20.27 (Test: 120 000(P) + 30 000(A))	R150 000

**Comment**

The **investment in the associate** will appear in the consolidated statement of financial position at an amount of R114 000 (84 000 + 30 000) at 31 December 20.27.

Calculations**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition (01/01/20.22)			
Share capital	195 000	78 000	
Retained earnings	15 000	6 000	
	210 000	84 000 (84 000)	
Investment in A Ltd		—	
ii Since acquisition			
• To beginning of current year (20.22 – 20.26)			
Retained earnings (70 000 – 15 000)	55 000		22 000
• Current year (20.27)			
Profit for the year	50 000		20 000
Dividends	(30 000)		(12 000)
	R285 000		R30 000

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in A Ltd (SFP)	42 000	
	Share of profit of associate (P/L)		20 000
	Retained earnings – Beginning of year (SCE)		22 000
J2	Dividend income (P/L)	12 000	
	Investment in A Ltd (SFP)		12 000

Example 11.1b**Fair value adjustment at acquisition date**

Assume the same information as in example 11.1a. All the assets and liabilities of A Ltd were fairly valued on 1 January 20.22, except for machinery that was undervalued with R25 000 (after taking into account 27% tax). The machinery had a remaining useful life of eight years.

Solution 11.1b

Calculations

C1 Analysis of owners' equity of A Ltd

	Total	P Ltd 40%	
		At	Since
i At acquisition (01/01/20.22)			
Share capital	195 000	78 000	
Retained earnings	15 000	6 000	
Revaluation surplus (machinery)	25 000	10 000	
	235 000	94 000	
Investment in A Ltd		(84 000)	
Gain from a bargain purchase		10 000	
ii Since acquisition			
• To beginning of current year (20.22–20.26)			
Retained earnings			
(70 000 – 15 000 – (25 000/8 × 5)(depreciation))	39 375		15 750
• Current year (20.27)			
Profit for the year (50 000 – (25 000/8))	46 875		18 750
Dividends	(30 000)		(12 000)
	R291 250		R22 500

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in A Ltd (SFP) Retained earnings – Beginning of year (SCE)	10 000	10 000
J2	Investment in A Ltd (SFP) Share of profit of associate (P/L) Retained earnings – Beginning of year (SCE)	34 500	18 750 15 750
J3	Dividend income (P/L) Investment in A Ltd (SFP)	12 000	12 000



Comment

The gain from a bargain purchase was recognised in profit or loss in 20.22 and would therefor impact on the opening balance of retained earnings in 20.27.

The **investment in the associate** will appear in the consolidated statement of financial position at an amount of R116 500 (84 000 + 10 000 + 22 500) at 31 December 20.27.

4 Treatment of the reserves of an associate

☐ Transfers to and from reserves via the statement of changes in equity of the associate

If a subsidiary makes a transfer to a reserve in the statement of changes in equity during the current year, it is customary to transfer the portion of the transfer attributable to the shareholding of the investor to the specific reserve in the consolidated statement of changes in equity. If an associate makes a transfer to a reserve, the transfer is treated in a manner similar to transfers made by subsidiaries. This transfer reflects the fact that the investor influences the policy and operating decisions of the associate.

☐ Revaluation of the assets of an associate since acquisition

If the assets of an associate are revalued after the acquisition of the investment, the attributable portion of the revaluation surplus that is created must be recognised within other comprehensive income in the consolidated statements of the investor, and the carrying amount of the investment must be increased by the amount of the investor's share in the revaluation surplus of the associate. The portion of the revaluation that has already been taken into account in the investor's original cost of the investment is not taken into consideration.

Any surplus that was paid on the acquisition date must, as far as possible, be allocated to the assets of the associate on the date of acquisition. If a depreciable asset was revalued in this manner, the accompanying adjustment to the depreciation expense must be set off in the calculation of the share of profit of the associate. The above treatment is in accordance with the basic viewpoint that the consolidation process and the equity method are based on the same procedures and principles.

Example 11.2	Revaluation surplus of an associate
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
ASSETS		
Property, plant and equipment	250 000	150 000
Investment in A Ltd (40 000 shares at cost)	50 000	–
Inventories	350 000	140 000
Total assets	R650 000	R290 000
EQUITY AND LIABILITIES		
Share capital (250 000/100 000 shares)	250 000	100 000
Retained earnings	300 000	120 000
Other components of equity (revaluation surplus)	–	30 000
Non-controlling interests	50 000	–
Deferred tax liability	–	20 000
Long-term loans	50 000	20 000
Total equity and liabilities	R650 000	R290 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
Profit	378 000	150 000
Dividends received	4 000	–
Profit before tax	382 000	150 000
Income tax expense	(152 000)	(60 000)
PROFIT FOR THE YEAR	230 000	90 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Revaluation of land	–	30 000
Other comprehensive income for the year, net of tax	–	30 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R230 000	R120 000
Profit attributable to:		
Owners of the parent	215 000	90 000
Non-controlling interests	15 000	–
	R230 000	R90 000
Total comprehensive income attributable to:		
Owners of the parent	215 000	120 000
Non-controlling interests	15 000	–
	R230 000	R120 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	100 000	40 000
Changes in equity for 20.27		
Dividends	(15 000)	(10 000)
Total comprehensive income for the year:		
Profit for the year	215 000	90 000
Balance at 31 December 20.27	R300 000	R120 000

Additional information

- On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd when the retained earnings of A Ltd amounted to R10 000. Since that date, P Ltd exercises significant influence over the financial and operating policy decisions of A Ltd.
- The revaluation surplus of A Ltd arose on 31 December 20.27 when the land was revalued.
- Ignore taxation.

Solution 11.2

P LTD GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27

ASSETS	
Non-current assets	
Property, plant and equipment (P)	250 000
Investment in associate (50 000 + 56 000)	106 000
	356 000
Current assets	
Inventories (P)	350 000
Total assets	R706 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	250 000
Retained earnings	344 000
Other components of equity (revaluation surplus)	12 000
	606 000
Non-controlling interests	50 000
Total equity	656 000
Non-current liabilities	
Long-term loans	50 000
Total equity and liabilities	R706 000

P LTD GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER
COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27

Profit (P)	378 000
Share of profit of associate	36 000
Profit before tax	414 000
Income tax expense (P)	(152 000)
PROFIT FOR THE YEAR	262 000
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	12 000
Other comprehensive income for the year, net of tax	12 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R274 000
Profit attributable to:	
Owners of the parent	247 000
Non-controlling interests	15 000
	R262 000
Total comprehensive income attributable to:	
Owners of the parent	259 000
Non-controlling interests	15 000
	R274 000

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27						
	Share capital	Retained earnings	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.27	250 000	* 112 000	–	362 000	35 000	397 000
Changes in equity for 20.27						
Dividends	–	(15 000)	–	(15 000)	–	(15 000)
Total comprehensive income for the year						
Profit for the year	–	247 000	–	247 000	15 000	262 000
Other comprehensive income	–	–	12 000	12 000	–	12 000
Balance at 31 Dec 20.27	R250 000	@ R344 000	R12 000	R606 000	R50 000	R656 000

* 100 000(P) + 12 000 = 112 000
@ Test: 300 000(P) + 44 000(A) = 344 000

Calculations

C1 Analysis of owners' equity of A Ltd

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	10 000	4 000	
	110 000	44 000	
Investment in A Ltd		(50 000)	
Goodwill		(6 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (40 000 – 10 000)	30 000		12 000
• Current year			
Profit for the year	90 000		36 000
Dividends	(10 000)		(4 000)
Revaluation surplus	30 000		12 000
	R250 000		R12 000 RS
			R44 000 RE

C2 Pro forma consolidation journal entry

		Dr R	Cr R
J1	Investment in A Ltd (SFP)(12 000 + 44 000)	56 000	
	Share of profit of associate (P/L)		36 000
	Share of other comprehensive income of associate (OCI)		12 000
	Retained earnings – Beginning of year (SCE)		12 000
	Dividend income (P/L)	4 000	

5 Cumulative preference shares

When applying the equity method, only the income attributable to equity or ordinary shares is included. Preference shares can be classified either as equity or as a financial liability. If an associate has issued cumulative preference shares which are classified as equity, the current dividend payable on these shares should be deducted when determining the income or loss attributable to the ordinary shareholders, irrespective of whether such dividends have been declared. If the preference shares are classified as a financial liability, the dividends are regarded as interest and would therefore have already been recognised as an expense in the calculation of the associate's profit for the year (IAS 28.37).

6 Reporting dates/Accounting policies☐ **Non-coterminous year-ends**

The investor uses the most recent available financial statements of the associate in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor.

When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions that occur between the date of the associate's financial statements and the date of the investor's financial statements. The difference may not be more than three months. When the difference is more than three months, the associate prepares, for the use of the investor, statements as at the same date as the financial statements of the investor (IAS 28.33–34).

☐ **Different accounting policies**

The investor's financial statements are usually prepared using uniform accounting policies for like transactions and events in similar circumstances. In cases where an associate uses accounting policies other than those adopted by the investor for like transactions and events in similar circumstances, appropriate adjustments have to be made to the associate's financial statements when they are used by the investor in applying the equity method (IAS 28.35).

7 Losses of an associate

If an associate suffers a loss during a financial year, the carrying amount of the investment is reduced according to the equity method by the investor's attributable portion of the loss. If the attributable portion of the loss exceeds the carrying amount of the investment, the write-off must be limited to the investor's net investment in the associate.

The investor's net investment in the associate includes the carrying amount of the investment in equity and other long-term interests of the associate such as loans to the associate. However, items for which settlement has been planned and will take place in the foreseeable future, for instance long-term loans for which security has been provided and trade payables, are not included.

If the associate consequently makes a profit, the equity method should only be resumed as soon as the investor's attributable portion of the profit exceeds the losses that were not previously recognised.

If the investor has guaranteed certain of the company's debts, the possibility exists that a greater loss may be suffered. In this case, an additional provision should be created for the amount of the loss. (IAS 28.38–39).

Example 11.3

Attributable loss of an associate

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
ASSETS		
Property, plant and equipment	440 000	35 000
Investment in A Ltd – 40 000 ordinary shares at cost	50 000	–
– 10 000 preference shares at cost	10 000	–
Inventories	300 000	150 000
Total assets	R800 000	R185 000
EQUITY AND LIABILITIES		
Share capital (400 000/100 000 shares)	400 000	100 000
6% non-redeemable preference shares (20 000 shares)	–	20 000
Retained earnings	300 000	65 000
Non-controlling interests	100 000	–
Total equity and liabilities	R800 000	R185 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
PROFIT FOR THE YEAR	300 000	200 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R300 000	R200 000
Total comprehensive income attributable to:		
Owners of the parent	260 000	200 000
Non-controlling interests	40 000	—
	R300 000	R200 000

**EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27**

	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	140 000	(135 000)
Changes in equity for 20.27		
Dividends	(100 000)	–
Total comprehensive income for the year:		
Profit for the year	260 000	200 000
Balance at 31 December 20.27	R300 000	R65 000

Additional information

On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd when the retained earnings of A Ltd amounted to R25 000. On the same date, P Ltd also acquired a 50% interest in the 6% non-redeemable non-cumulative preference share capital at R10 000. Since that date, P Ltd has exercised significant influence over the financial and operating policy decisions of A Ltd. Ignore taxation.

Solution 11.3

**P LTD GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20.27**

ASSETS	
Non-current assets	
Property, plant and equipment (P)	440 000
Investment in associate (50 000 + 16 000 + 10 000)	76 000
	516 000
Current assets	
Inventories (P)	300 000
Total assets	R816 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	400 000
Retained earnings	316 000
	716 000
Non-controlling interests	100 000
Total equity	816 000
Total equity and liabilities	R816 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Profit (P)	300 000
Share of profit of associate	76 000
PROFIT FOR THE YEAR	376 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R376 000
Total comprehensive income attributable to:	
Owners of the parent	336 000
Non-controlling interests	40 000
	R376 000

P LTD GROUP EXTRACT FROM THE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27	
	Retained earnings
Balance at 1 January 20.27 (140 000(P) – 60 000(A))	80 000
Changes in equity for 20.27	
Dividends	(100 000)
Total comprehensive income for the year:	
Profit for the year	336 000
Balance at 31 December 20.27 (Test: 300 000(P) + 16 000(A))	R316 000

	Comment	
	The carrying amount of the investment is compiled as follows:	
	☐ Cost	50 000
	☐ Cumulative since acquisition equity	16 000
	• Retained earnings up to beginning of the current year	(60 000)
	• Profit for the current year	76 000
	☐ Investment in preference shares	10 000
		R76 000

Calculations**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	25 000	10 000	
	125 000	50 000 (50 000)	
Investment in A Ltd			
ii Since acquisition			
• To beginning of current year:			
Retained earnings (135 000 + 25 000)	(160 000)		(64 000)
Correction		(4 000)	4 000
• Current year			
Profit for the year	200 000		80 000
Correction		4 000	(4 000)
	R165 000		R16 000

**Comment**

Take note that P Ltd's attributable losses up to the beginning of the current year are limited to the net investment in A Ltd, namely the cost of R50 000 plus the investment in preference shares of R10 000. The surplus of R4 000 is analysed in the "At" column for control purposes.

In the current year, the first R4 000 of the profit is employed against the R4 000 attributable losses that were not recognised in previous years.

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Retained earnings – Beginning of the year (SCE)	60 000	
	Investment (ordinary shares) (SFP)		50 000
	Investment (preference shares) (SFP)		10 000
J2	Investment (ordinary shares) (SFP)	66 000	
	Investment (preference shares) (SFP)	10 000	
	Share of profit of associate (P/L)		76 000

8 Intragroup transactions

Unrealised intragroup profits may arise as a result of:

- ☐ sales by the investor to the associate, or
- ☐ sales by the associate to the investor.

IAS 28.28 requires the elimination of unrealised profits and losses on intragroup transactions where an associate is one of the parties (similar manner to that of the elimination of unrealised profits on intragroup transactions where a subsidiary is one of

the parties). The difference is however that only the percentage of interest in the associate must be eliminated. Where an associate is accounted for by use of the equity method, unrealised profits and losses arising from transactions between an investor (or its consolidated subsidiaries) and associates should be eliminated to the extent of the investor's interest in the associate.

Balances such as receivables, payables, loans to and loans from associates are not eliminated as the individual line items of the associate are not reflected in the equity accounted financial statements. Income and expense items such as interest received, interest paid and management fees items are also not eliminated.

Where an associate is accounted for by using the equity method, unrealised profits and losses resulting from upstream and downstream transactions between an entity (or its consolidated subsidiaries) and associates should be eliminated to the extent of the entity's interest in the associate (IAS 28.28). However, when downstream transactions provide evidence of an impairment of the transferred asset, the unrealised losses should be recognised in full by the investor. When upstream transactions provide evidence of a reduction of an impairment of the transferred asset, the investor shall recognise its share in the losses (IAS 28.29).

Example 11.4	Elimination of unrealised profit in inventories (investor company sells to associate)
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
ASSETS		
Property, plant and equipment	250 000	150 000
Investment in A Ltd (40 000 shares at cost)	54 000	–
Inventories	346 000	140 000
Total assets	R650 000	R290 000
EQUITY AND LIABILITIES		
Share capital (250 000/100 000 shares)	250 000	100 000
Retained earnings	300 000	140 000
Other components of equity (revaluation surplus)	–	50 000
Non-controlling interests	50 000	–
Long-term loans	50 000	–
Total equity and liabilities	R650 000	R290 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
Revenue	800 000	320 000
Cost of sales	(400 000)	(160 000)
Gross profit	400 000	160 000
Other income (dividend received)	4 000	–
Other expenses	(22 000)	(10 000)
Profit before tax	382 000	150 000
Income tax expense	(152 000)	(60 000)
PROFIT FOR THE YEAR	230 000	90 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Revaluation of land	–	50 000
Other comprehensive income for the year, net of tax	–	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R230 000	R140 000
Profit attributable to:		
Owners of the parent	215 000	90 000
Non-controlling interests	15 000	–
	R230 000	R90 000
Total comprehensive income attributable to:		
Owners of the parent	215 000	140 000
Non-controlling interests	15 000	–
	R230 000	R140 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	100 000	60 000
Changes in equity for 20.27		
Dividends	(15 000)	(10 000)
Total comprehensive income for the year:		
Profit for the year	215 000	90 000
Balance at 31 December 20.27	R300 000	R140 000

Additional information

- On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd when the retained earnings of A Ltd amounted to R10 000. At that stage, all the assets and liabilities of A Ltd were deemed to be fairly valued. Since 1 January 20.23, P Ltd has been exercising significant influence over the financial and operating policy decisions of A Ltd.

- 2 The revaluation surplus of A Ltd arose on 31 December 20.27 when the land was revalued.
- 3 Since 1 January 20.26, P Ltd has been selling inventories to A Ltd at a profit of 50% on cost. Included in the inventories of A Ltd on 31 December 20.26 is R15 000 in respect of such inventories at the cost for A Ltd. Included in the inventories of A Ltd on 31 December 20.27 is R30 000 in respect of such inventories at the cost for A Ltd. Total sales of P Ltd to A Ltd amounted to R100 000.
- 4 Assume a tax rate of 27%.

Solution 11.4

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	250 000
Investment in associate (54 000 + 72 000 – 2 000(J2) + 2 000(J3) – 4 000(J5))	122 000
Deferred tax (540(J2) – 540(J4) + 1080(J6))	1 080
	373 080
Current assets	
Inventories (P)	346 000
Total assets	R719 080
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	250 000
Retained earnings	349 080
Other components of equity (revaluation surplus)	20 000
	619 080
Non-controlling interests (P)	50 000
Total equity	669 080
Non-current liabilities	
Long-term loans	50 000
Total equity and liabilities	R719 080

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (800 000(P) + 6 000(J3) – 12 000(J5))	794 000
Cost of sales (400 000(P) + 4 000(J3) – 8 000(J5))	(396 000)
Gross profit	398 000
Other expenses (P)	(22 000)
Share of profit of associate	36 000
Profit before tax	412 000
Income tax expense (152 000(P) + 540(J4) – 1080(J6))	(151 460)
PROFIT FOR THE YEAR	260 540
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	20 000
Other comprehensive income for the year, net of tax	20 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R280 540
Profit attributable to:	
Owners of the parent	245 540
Non-controlling interests	15 000
	R260 540
Total comprehensive income attributable to:	
Owners of the parent	265 540
Non-controlling interests	15 000
	R280 540

P LTD GROUP EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27						
	Share capital	Retained earnings	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.27	250 000	* 118 540	–	368 540	35 000	403 540
Changes in equity for 20.27						
Total comprehensive income for the year:						
Profit for the year	–	245 540	–	245 540	15 000	260 540
Other comprehensive income	–	–	20 000	20 000	–	20 000
Dividends	–	(15 000)	–	(15 000)	–	(15 000)
Balance at 31 Dec 20.27	R250 000	@R349 080	R20 000	R619 080	R50 000	R669 080

* 100 000 + 20 000 – 1 460(J2) = 118 540
@ Test: 300 000(P) + 52 000(A) – 1 460(J2) + 6 000(J3) – 4 000(J3) – 540(J4) – 12 000(J5) + 8 000(J5) + 1 080(J6) = 349 080



Comment

The carrying amount of the **investment in the associate** is compiled as follows:

☐ Cost	54 000
☐ Cumulative since acquisition equity	72 000
• Retained earnings up to beginning of the current year	20 000
• Profit for the current year	32 000
• Revaluation surplus	20 000
☐ Unrealised profit eliminated in closing inventories	(4 000)
	<u>R122 000</u>

Calculations**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	10 000	4 000	
	110 000	44 000	
Investment in A Ltd		(54 000)	
Goodwill		(R10 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (60 000 – 10 000)	50 000		20 000
• Current year			
Profit for the year	90 000		36 000
Dividends	(10 000)		(4 000)
Revaluation surplus	50 000		20 000
	R290 000		R52 000 RE
			R20 000 RS

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in A Ltd (SFP)	72 000	
	Share of other comprehensive income of associate (OCI)		20 000
	Share of profit of associate (P/L)		36 000
	Retained earnings – Beginning of the year (SCE)		20 000
	Dividend income (P/L)	4 000	
	Bringing to book of associate		
J2	Retained earnings – Beginning of year (SCE)	1 460	
	Deferred tax (SFP) (2 000 × 27%)	540	
	Investment in associate (SFP)(15 000 × 50/150 × 40%)		2 000
	Correction of retained earnings at the beginning of the year		
J3	Cost of sales (P/L)(15 000 × 100/150 × 40%)	4 000	
	Investment in associate (SFP)(15 000 × 50/150 × 40%)	2 000	
	Revenue (P/L)(15 000 × 40%)		6 000
	Realisation of unrealised profit in opening inventories of A Ltd		
J4	Income tax expense (P/L)(2 000 × 27%)	540	
	Deferred tax (SFP)		540
	Tax implication of realisation of unrealised profit in opening inventories of A Ltd		

continued

		Dr R	Cr R
J5	Revenue (P/L)(30 000 × 40%) Cost of sales (P/L)(30 000 × 100/150 × 40%) Investment in associate (SFP) [(30 000 – 20 000) × 40%] Elimination of unrealised profit in closing inventories of A Ltd	12 000	8 000 4 000
J6	Deferred tax (SFP) Income tax expense (P/L)(4 000 × 27%) Tax implication of unrealised profit in closing inventories of A Ltd	1 080	1 080

Example 11.5	Elimination of unrealised profit in inventories (associate sold to investor company)
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
ASSETS		
Property, plant and equipment	250 000	150 000
Investment in A Ltd (40 000 shares at cost)	54 000	–
Inventories	346 000	140 000
Total assets	R650 000	R290 000
EQUITY AND LIABILITIES		
Share capital (250 000/100 000 shares)	250 000	100 000
Retained earnings	300 000	140 000
Other components of equity (revaluation surplus)	–	50 000
Non-controlling interests	50 000	–
Long-term loan	50 000	–
Total equity and liabilities	R650 000	R290 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
Revenue	800 000	320 000
Cost of sales	(400 000)	(160 000)
Gross profit	400 000	160 000
Other income (dividends received)	4 000	–
Other expenses	(22 000)	(10 000)
Profit before tax	382 000	150 000
Income tax expense	(152 000)	(60 000)
PROFIT FOR THE YEAR	230 000	90 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Revaluation of land	–	50 000
Other comprehensive income for the year, net of tax	–	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R230 000	R140 000
Profit attributable to:		
Owners of the parent	215 000	90 000
Non-controlling interests	15 000	–
	R230 000	R90 000
Total comprehensive income attributable to:		
Owners of the parent	215 000	140 000
Non-controlling interests	15 000	–
	R230 000	R140 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	100 000	60 000
Changes in equity for 20.27		
Dividends	(15 000)	(10 000)
Total comprehensive income for the year:		
Profit for the year	215 000	90 000
Balance at 31 December 20.27	R300 000	R140 000

Additional information

- 1 On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd when the retained earnings of A Ltd amounted to R10 000. At that stage, all the assets and liabilities of A Ltd were deemed to be fairly valued. Since 1 January 20.23, P Ltd has been exercising significant influence over the financial and operating policy decisions of A Ltd.
- 2 The revaluation surplus of A Ltd arose on 31 December 20.27 when the land was revalued.
- 3 Since 1 January 20.26, A Ltd has been selling inventories to P Ltd at a profit of 50% on cost. Included in P Ltd's inventories on 31 December 20.26 is R15 000 in respect of such inventories at the cost for P Ltd. Included in the inventories of P Ltd on 31/12/20.27 is R30 000 in respect of such inventories at the cost for P Ltd. Total sales of A Ltd to P Ltd amounted to R100 000.
- 4 Assume a tax rate of 27%.

Solution 11.5

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	250 000
Investment in associate (54 000 + 72 000)	126 000
Deferred tax (J5)	1 080
	377 080
Current assets	
Inventories (346 000(P) – 4 000(J4))	342 000
Total assets	R719 080
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	250 000
Retained earnings	349 080
Other components of equity (revaluation surplus)	20 000
	619 080
Non-controlling interests	50 000
Total equity	669 080
Non-current liabilities	
Long-term loans	50 000
Total equity and liabilities	R719 080

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (P)	800 000
Cost of sales (P)	(400 000)
Gross profit	400 000
Other expenses (P)	(22 000)
Share of profit of associate (36 000(J1) + 2 000(J2) – 540(J3) – 4 000(J4) + 1080(J5))	34 540
Profit before tax	412 540
Income tax expense (P)	(152 000)
PROFIT FOR THE YEAR	260 540
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	20 000
Other comprehensive income for the year, net of tax	20 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R280 540
Profit attributable to:	
Owners of the parent	245 540
Non-controlling interests	15 000
	R260 540
Total comprehensive income attributable to:	
Owners of the parent	265 540
Non-controlling interests	15 000
	R280 540

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27						
	Share capital	Retained earnings	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.27	250 000	* 118 540	–	368 540	35 000	403 540
Changes in equity for 20.27						
Dividends	–	(15 000)	–	(15 000)	–	(15 000)
Total comprehensive income for the year:						
Profit for the year	–	245 540	–	245 540	15 000	260 540
Other comprehensive income	–	–	20 000	20 000	–	20 000
Balance at 31 Dec 20.27	R250 000	@R349 080	R20 000	R619 080	R50 000	R669 080

* 100 000 + 20 000 – 2 000(J2) + 540(J3) = 118 540
@ 300 000(P) + 52 000(A) – 4 000(J4) + 1 080(J5) = 349 080

	Comment	
	The carrying amount of the investment in the associate is compiled as follows:	
	☐ Cost	54 000
	☐ Cumulative since acquisition equity	72 000
	• Retained earnings up to beginning of the current year	20 000
	• Profit for the current year • Revaluation surplus	32 000 20 000
		<u>R126 000</u>

Calculations**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	10 000	4 000	
	110 000	44 000	
Investment in A Ltd		(54 000)	
Goodwill		(R10 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (60 000 – 10 000)	50 000		20 000
• Current year			
Profit for the year	90 000		36 000
Dividends	(10 000)		(4 000)
Revaluation surplus	50 000		20 000
	R290 000		R52 000 RE
			R20 000 RS

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in A Ltd (SFP) Retained earnings – Beginning of the year (SCE) Share of other comprehensive income of associate (OCI) Share of profit of associate (P/L) Dividend income (P/L) Bringing to book of associate	72 000 4 000	20 000 20 000 36 000
J2	Retained earnings – Beginning of year (SCE) Share of profit of associate (P/L) Elimination of unrealised profit in opening inventories of P Ltd (15 000 × 50/150 × 40%)	2 000	2 000
J3	Share of profit of associate (P/L) Retained earnings – Beginning of year (SCE) Tax implication of unrealised profit in opening inventories of P Ltd (2 000 × 27%)	540	540
J4	Share of profit of associate (P/L) Inventories (SFP) Elimination of unrealised profit in closing inventories of P Ltd (30 000 × 50/150 × 40%)	4 000	4 000
J5	Deferred tax (SFP) Share of profit of associate (P/L) Tax implication of unrealised profit in closing inventories of P Ltd (4 000 × 27%)	1 080	1 080

Example 11.6	Elimination of unrealised profit in equipment (investor sells to associate)
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
ASSETS		
Property, plant and equipment	250 000	150 000
Investment in A Ltd (40 000 shares at cost)	54 000	–
Inventories	346 000	140 000
Total assets	R650 000	R290 000
EQUITY AND LIABILITIES		
Share capital (250 000/100 000 shares)	250 000	100 000
Retained earnings	300 000	140 000
Other components of equity (revaluation surplus)	–	50 000
Non-controlling interests	50 000	–
Long-term loans	50 000	–
Total equity and liabilities	R650 000	R290 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
Revenue	800 000	320 000
Cost of sales	(400 000)	(160 000)
Gross profit	400 000	160 000
Other income (dividend received)	4 000	–
Other expenses	(22 000)	(10 000)
Profit before tax	382 000	150 000
Income tax expense	(152 000)	(60 000)
PROFIT FOR THE YEAR	230 000	90 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Revaluation of land	–	50 000
Other comprehensive income for the year, net of tax	–	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R230 000	R140 000
Profit attributable to:		
Owners of the parent	215 000	90 000
Non-controlling interests	15 000	–
	R230 000	R90 000
Total comprehensive income attributable to:		
Owners of the parent	215 000	140 000
Non-controlling interests	15 000	–
	R230 000	R140 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	100 000	60 000
Changes in equity for 20.27		
Dividends	(15 000)	(10 000)
Total comprehensive income for the year:		
Profit for the year	215 000	90 000
Balance at 31 December 20.27	R300 000	R140 000

Additional information

- On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd when the retained earnings of A Ltd amounted to R10 000. At that stage, all the assets and liabilities of A Ltd were deemed to be fairly valued. Since 1 January 20.23, P Ltd has been exercising significant influence over the financial and operating policy decisions of A Ltd.
- The revaluation surplus of A Ltd arose on 31 December 20.27 when the land was revalued.
- On 1 January 20.25, P Ltd sold equipment to A Ltd at a profit of 50% on cost (for P Ltd). The equipment is still included in the equipment of A Ltd on 31 December 20.27. Depreciation is provided at 20% per annum on the cost of the equipment. The cost of the equipment in the books of A Ltd was R15 000.
- Assume a tax rate of 27%.

Solution 11.6

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	250 000
Investment in associate (54 000 + 72 000 – 1 200(J2) + 400(J3))	125 200
Deferred tax (324(J2) – 108(J4))	216
	375 416
Current assets	
Inventories (P)	346 000
Total assets	R721 416
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	250 000
Retained earnings	351 416
Other components of equity (revaluation surplus)	20 000
	621 416
Non-controlling interests	50 000
Total equity	671 416
Non-current liabilities	
Long-term loans	50 000
Total equity and liabilities	R721 416

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (P)	800 000
Cost of sales (P)	(400 000)
Gross profit	400 000
Other expenses (22 000(P) – 400(J3))	(21 600)
Share of profit of associate	36 000
Profit before tax	414 400
Income tax expense (152 000(P) + 108(J4))	(152 108)
PROFIT FOR THE YEAR	262 292
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	20 000
Other comprehensive income for the year, net of tax	20 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R282 292
Profit attributable to:	
Owners of the parent	247 292
Non-controlling interests	15 000
	R262 292
Total comprehensive income attributable to:	
Owners of the parent	267 292
Non-controlling interests	15 000
	R282 292

P LTD GROUP EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27						
	Share capital	Retained earnings	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.27	250 000	* 119124	–	369 124	35 000	404 124
Changes in equity for 20.27						
Dividends	–	(15 000)	–	(15 000)	–	(15 000)
Total comprehensive income for the year:						
Profit for the year	–	247 292	–	247 292	15 000	262 292
Other comprehensive income	–	–	20 000	20 000	–	20 000
Balance at 31 Dec 20.27	R250 000	@ R351 416	R20 000	R621 416	R50 000	R671 416

* 100 000 + 20 000 – 876(J2) = 119124
@ 300 000(P) + 52 000(A) – 876(J2) + 400(J3) – 108(J4) = 351416

	Comment	
	The carrying amount of the investment in associate is compiled as follows:	
	☐ Cost	54 000
	☐ Cumulative since acquisition equity	72 000
	• Retained earnings up to beginning of the current year	20 000
	• Profit for the current year	32 000
	• Revaluation surplus	20 000
	☐ Unrealised profit included in the closing balance of equipment	(800)
		<u>R125 200</u>

Calculations**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	10 000	4 000	
	110 000	44 000	
Investment in A Ltd		(54 000)	
Goodwill		(R10 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (60 000 – 10 000)	50 000		20 000
• Current year			
Profit for the year	90 000		36 000
Dividends	(10 000)		(4 000)
Revaluation surplus	50 000		20 000
	R290 000		R52 000 RE
			R20 000 RS

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in A Ltd (SFP) Retained earnings – Beginning of the year (SCE) Share of other comprehensive income of associate (OCI) Share of profit of associate (P/L) Dividend income (P/L) Bringing to book of associate	72 000 4 000	20 000 20 000 36 000
J2	Retained earnings – Beginning of year (SCE) (1 200 – 324) Deferred tax (SFP) (1 200 × 27%) Investment in associate (SFP) ((15 000 × 50/150 × 40% = 2 000) – (2 000 × 20% = 400) – 400) Correction of retained earnings at the beginning of the year in respect of unrealised profit included in the equipment of A Ltd	876 324	1 200
J3	Investment in associate (SFP) Depreciation (P/L) Realisation of unrealised profit in the current year through depreciation	400	400
J4	Income tax expense (P/L) (400 × 27%) Deferred tax (SFP) Tax implication of realisation of unrealised profit in the current year	108	108

Example 11.7	Elimination of unrealised profit in equipment (associate sells to investor company)
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
ASSETS		
Property, plant and equipment	250 000	150 000
Investment in A Ltd (40 000 shares at cost)	54 000	–
Inventories	346 000	140 000
Total assets	R650 000	R290 000
EQUITY AND LIABILITIES		
Share capital (250 000/100 000 shares)	250 000	100 000
Retained earnings	300 000	140 000
Other components of equity (revaluation surplus)	–	50 000
Non-controlling interests	50 000	–
Long-term loan	50 000	–
Total liabilities	R650 000	R290 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd
Revenue	800 000	320 000
Cost of sales	(400 000)	(160 000)
Gross profit	400 000	160 000
Other income (dividend received)	4 000	–
Other expenses	(22 000)	(10 000)
Profit before tax	382 000	150 000
Income tax expense	(152 000)	(60 000)
PROFIT FOR THE YEAR	230 000	90 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Revaluation of land	–	50 000
Other comprehensive income for the year, net of tax	–	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R230 000	R140 000
Profit attributable to:		
Owners of the parent	215 000	90 000
Non-controlling interests	15 000	–
	R230 000	R90 000
Total comprehensive income attributable to:		
Owners of the parent	215 000	140 000
Non-controlling interests	15 000	–
	R230 000	R140 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd
Balance at 1 January 20.27	100 000	60 000
Changes in equity for 20.27		
Dividends	(15 000)	(10 000)
Total comprehensive income for the year:		
Profit for the year	215 000	90 000
Balance at 31 December 20.27	R300 000	R140 000

Additional information

- 1 On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd when the retained earnings of A Ltd amounted to R10 000. At that stage, all the assets and liabilities of A Ltd were deemed to be fairly valued. Since 1 January 20.23, P Ltd has been exercising significant influence over the financial and operating policy decisions of A Ltd.
- 2 The revaluation surplus of A Ltd arose on 31 December 20.27 when the land was revalued.
- 3 On 1 January 20.25, A Ltd sold equipment to P Ltd at a profit of 50% on cost (for A Ltd). The equipment is still included in the equipment of P Ltd on 31 December 20.27. Depreciation is provided at 20% per annum on the cost of the equipment. The cost of the equipment to P Ltd was R15 000.
- 4 Assume a tax rate of 27%.

Solution 11.7

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (250 000 – 1 200(J2) + 400(J3))	249 200
Investment in associate (54 000 + 72 000)	126 000
Deferred tax (324(J2) – 108(J4))	216
	375 416
Current assets	
Inventories (P)	346 000
Total assets	R721 416
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	250 000
Retained earnings	351 416
Other components of equity (revaluation surplus)	20 000
	621 416
Non-controlling interests	50 000
Total equity	671 416
Non-current liabilities	
Long-term loan	50 000
Total equity and liabilities	R721 416

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue	800 000
Cost of sales	(400 000)
Gross profit	400 000
Other expenses	(22 000)
Share of profit of associate (36 000(J1) + 400(J3) – 108(J4))	36 292
Profit before tax	414 292
Income tax expense	(152 000)
PROFIT FOR THE YEAR	262 292
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	20 000
Other comprehensive income for the year, net of tax	20 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R282 292
Profit attributable to:	
Owners of the parent	247 292
Non-controlling interests	15 000
	R262 292
Total comprehensive income attributable to:	
Owners of the parent	267 292
Non-controlling interests	15 000
	R282 292

P LTD GROUP EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27						
	Share capital	Retained earnings	Revaluation surplus	Total	Non-control-ling interests	Total equity
Balance at 1 Jan 20.27	250 000	* 119 124	–	369 124	35 000	404 124
Changes in equity for 20.27						
Dividends	–	(15 000)	–	(15 000)	–	(15 000)
Total comprehensive income for the year:						
Profit for the year	–	247 292	–	247 292	15 000	262 292
Other comprehensive income	–	–	20 000	20 000	–	20 000
Balance at 31 Dec 20.27	R250 000	# R351 416	R20 000	R621 416	R50 000	R671 416

* 100 000 + 20 000 – 876(J2) = 119 124

300 000(P) + 52 000(A) – 876(J2) + 400(J3) – 108(J4) = 351 416

	Comment	
	The carrying amount of the investment in associate is compiled as follows:	
	☐ Cost	54 000
	☐ Cumulative since acquisition equity	72 000
	• Retained earnings up to beginning of the current year	20 000
	• Profit for the current year	32 000
• Revaluation surplus		20 000
		R126 000

Calculations

C1 Analysis of owners' equity of A Ltd

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	10 000	4 000	
	110 000	44 000	
Investment in A Ltd		(54 000)	
Goodwill		(R10 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (60 000 – 10 000)	50 000		20 000
• Current year			
Profit for the year	90 000		36 000
Dividends	(10 000)		(4 000)
Revaluation surplus	50 000		20 000
	R290 000		R52 000 RE
			R20 000 RR

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in A Ltd (SFP) Retained earnings – Beginning of the year (SCE) Share of other comprehensive income of associate (OCI) Share of profit of associate (P/L) Dividend income (P/L) Bringing to book of associate	72 000 4 000	 20 000 20 000 36 000
J2	Retained earnings – Beginning of year (SCE)(1 200 – 324) Deferred tax (SFP) $((2\,000 - 800) \times 27\%)$ Equipment – Cost (SFP)(15 000 $\times$ 50/150 $\times$ 40%) Accumulated depreciation on equipment (SFP) $(2\,000 \times 20\% \times 2 \text{ years})$ Correction of retained earnings at the beginning of the year in respect of unrealised profit included in the equipment of P Ltd	876 324 800	 2 000
J3	Accumulated depreciation on equipment (SFP) Share of profit of associate (P/L) Realisation of unrealised profit in the current year through depreciation	400	400
J4	Share of profit of associate (P/L) $(400 \times 27\%)$ Deferred tax (SFP) Tax implication of realisation of unrealised profit in the current year	108	108

9 Deferred tax implications as a result of the application of the equity method

Income tax arising from investments in associates is accounted for in accordance with **IAS 12 Income Taxes**.

Temporary differences arise when the carrying amount of the investment in the associate (namely the investor's portion of the net assets of the investee, including goodwill) is no longer the same as the tax base (which is often the cost) thereof. Such differences may arise in various circumstances, for example:

- ☐ the existence of undistributed profits of the associate; and
- ☐ a reduction in the carrying amount of an investment in an associate to its recoverable amount (i.e. an impairment loss).

In consolidated financial statements, there may be a difference between the investment in the associate compared to the amount of the investment in the separate financial statements of the investor, if the investor carries the investment in its separate financial statements at cost or a revalued amount.

An entity should recognise a deferred tax liability for all taxable temporary differences that relate to investments in associates, except to the extent that both the following conditions have been met:

- ☐ the investor can control the timing of the write-back of the temporary difference; and
- ☐ it is probable that the temporary difference will not be written back in the foreseeable future.

An investment in an associate can be recovered in one of two ways:

- ☐ the receipt of dividends from the associate; or
- ☐ the sale of the investment in the associate.

Section 10(1)(k) of the Income Tax Act 58 of 1962 stipulates that any dividend received by or accrued to any person is exempt. The receipt of dividends from the associate can therefore not lead to taxable temporary differences.

The sale of an investment in an associate will lead to a capital profit which will be taxed at the capital gains tax rate. A deferred tax liability will have to be created and the deferred tax liability must be calculated as the difference between the carrying amount of the investment in the associate and the tax base thereof (usually the cost of the investment) multiplied by the capital gains tax rate. The deferred tax liability should not be created at the normal tax rate.

An entity should recognise a deferred tax asset for all deductible temporary differences arising from investments in associates to the extent that, and only to the extent that, it is probable that:

- ☐ the temporary difference will be written back in the foreseeable future; and
- ☐ taxable income will be available against which the temporary difference may be utilised.

In deciding whether a deferred tax asset should be recognised for deductible temporary differences that bear relation to investments in associates, an entity considers the guidance set out in IAS 12.

10 Associates in horizontal/vertical groups

Associates in horizontal groups

Where an investor has more than one associate, the results of the associates are grouped together in the consolidated financial statements.

Example 11.8	Associates in a horizontal group
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27			
	P Ltd Group	A Ltd	Z Ltd
ASSETS			
Property, plant and equipment	315 000	150 000	250 000
Investment in A Ltd (40 000 shares at cost)	50 000	–	–
Investment in Z Ltd (50 000 shares at cost)	85 200	–	–
Inventories	349 800	250 000	200 000
Total assets	R800 000	R400 000	R450 000
EQUITY AND LIABILITIES			
Share capital (200 000/100 000/250 000 shares)	200 000	100 000	250 000
Retained earnings	500 000	300 000	200 000
Non-controlling interests	100 000	–	–
Total equity and liabilities	R800 000	R400 000	R450 000

**STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.27**

	P Ltd Group	A Ltd	Z Ltd
Profit	315 000	255 000	170 000
Other income (dividend received)	16 000	–	–
Profit before tax	331 000	255 000	170 000
Income tax expense	(131 000)	(105 000)	(70 000)
PROFIT FOR THE YEAR	200 000	150 000	100 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R200 000	R150 000	R100 000
Total comprehensive income attributable to:			
Owners of the parent	150 000	150 000	100 000
Non-controlling interests	50 000	–	–
	R200 000	R150 000	R100 000

**EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27**

	Retained earnings		
	P Ltd Group	A Ltd	Z Ltd
Balance at 31 December 20.26	400 000	180 000	120 000
Changes in equity for 20.27			
Dividends paid: 31 December 20.27	(50 000)	(30 000)	(20 000)
Total comprehensive income for the year:			
Profit for the year	150 000	150 000	100 000
Balance at 31 December 20.27	R500 000	R300 000	R200 000

Additional information

- On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd, when the retained earnings of A Ltd amounted to R20 000. Since the acquisition date, P Ltd has been exercising significant influence over the financial and operating decisions of A Ltd.
- On 30 June 20.27, P Ltd acquired 20% of the issued share capital of Z Ltd for R85 200. Since the acquisition date, P Ltd has been exercising significant influence on the financial and operating decisions of Z Ltd.
- Z Ltd's profit for 20.27 accrued evenly, with the exception of R2 000 included in income tax expense, which arose during the second half of the year.

Solution 11.8

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	315 000
Investment in associates (50 000 + 85 200 + 112 000 + 5 800)	253 000
	568 000
Current assets	
Inventories (P)	349 800
Total assets	R917 800
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	200 000
Retained earnings	617 800
	817 800
Non-controlling interests	100 000
Total equity	917 800
Total equity and liabilities	R917 800

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Profit	315 000
Share of profit of associate (60 000 + 9 800)	69 800
Profit before tax	384 800
Income tax expense	(131 000)
PROFIT FOR THE YEAR	253 800
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R253 800
Total comprehensive income attributable to:	
Owners of the parent	203 800
Non-controlling interests	50 000
	R253 800

P LTD GROUP
EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27

	Retained earnings
Balance at 1 January 20.27 (400 000(P) + 64 000(A))	464 000
Changes in equity for 20.27	
Dividends	(50 000)
Total comprehensive income for the year:	
Profit for the year	203 800
Balance at 31 December 20.27 (Test: 500 000(P) + 112 000(A) + 5 800(Z))	R617 800

Calculations**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	20 000	8 000	
	120 000	48 000	
Investment in A Ltd		(50 000)	
Goodwill		(R2 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (180 000 – 20 000)	160 000		64 000
• Current year			
Profit for the year	150 000		60 000
Dividends	(30 000)		(12 000)
	R400 000		R112 000

C2 Analysis of owners' equity of Z Ltd

	Total	P Ltd 20%	
		At	Since
i At acquisition			
Share capital	250 000	50 000	
Retained earnings (120 000 + 51 000*)	171 000	34 200	
	421 000	84 200	
Investment in Z Ltd		(85 200)	
Goodwill		(R1 000)	
ii Since acquisition			
• Current year			
Profit up to 31/12/20.27	49 000*		9 800
Dividends	(20 000)		(4 000)
	R450 000		R5 800

* Profit split:

Before acquisition date = $(100\,000 + 2\,000) \times 6/12 = 51\,000$

After acquisition date = $[(100\,000 + 2\,000) \times 6/12] - 2\,000 = 49\,000$

Associates in vertical groups

Basically, three cases may occur:

- ☐ the associate is itself a parent; or
- ☐ the investment in the associate is held by a partially-owned subsidiary, or
- ☐ the investment in the associate is held by another associate of the parent.

1 The associate itself is a parent

Where the associate itself is a parent, the consolidated statements of the associate should be used to account for the results of the associate according to the equity method in the consolidated financial statements of the investor. Consider the following group: P Ltd, which also has various subsidiaries, owns 40% of the issued ordinary shares of A Ltd, which in turn owns 80% of the issued ordinary shares of S Ltd. The interest of A Ltd in the owners' equity of S Ltd must be analysed. The analysis is then used to calculate the consolidated owners' equity of A Ltd and to analyse P Ltd's interest therein.

Example 11.9**Investment in an associate which itself is a parent****STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27**

	P Ltd Group	A Ltd	S Ltd
ASSETS			
Property, plant and equipment	250 000	92 000	250 000
Investment in A Ltd (40 000 shares at cost)	50 000	–	–
Investment in S Ltd (80 000 shares at cost)	–	208 400	–
Inventories	400 000	99 600	50 000
Total assets	R700 000	R400 000	R300 000
EQUITY AND LIABILITIES			
Share capital (100 000 shares)	100 000	100 000	100 000
Retained earnings	400 000	300 000	200 000
Non-controlling interests	200 000	–	–
Total equity and liabilities	R700 000	R400 000	R300 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27

	P Ltd Group	A Ltd	S Ltd
Profit	660 000	322 000	168 000
Other income (dividend received)	8 000	8 000	–
Profit before tax	668 000	330 000	168 000
Income tax expense	(268 000)	(130 000)	(68 000)
PROFIT FOR THE YEAR	400 000	200 000	100 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R400 000	R200 000	R100 000
Total comprehensive income attributable to:			
Owners of the parent	300 000	200 000	100 000
Non-controlling interests	100 000	–	–
	R400 000	R200 000	R100 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27

	P Ltd Group	A Ltd	S Ltd
Balance at 1 January 20.27	150 000	120 000	110 000
Changes in equity for 20.27			
Dividends paid: 31 December 20.27	(50 000)	(20 000)	(10 000)
Total comprehensive income for the year:			
Profit for the year	300 000	200 000	100 000
Balance at 31 December 20.27	R400 000	R300 000	R200 000

Additional information

- 1 On 1 January 20.23, P Ltd acquired 40% of the issued share capital of A Ltd for R50 000, when the retained earnings of A Ltd amounted to R20 000. Since the acquisition date, P Ltd has been exercising significant influence over the financial and operating decisions of A Ltd.
- 2 On 30 June 20.27, A Ltd acquired 80% of the issued share capital of S Ltd for R208 400.
- 3 S Ltd's profit for 20.27 accrued evenly, with the exception of R1 000 included in income tax expense, which arose during the second half of the year.

Solution 11.9

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	250 000
Investment in associate (50 000 + 124 640)	174 640
	424 640
Current assets	
Inventories (P)	400 000
Total assets	R824 640
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	100 000
Retained earnings	524 640
	624 640
Non-controlling interests	200 000
Total equity	824 640
Total equity and liabilities	R824 640

P LTD GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS
AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.27

Profit (P)	660 000
Share of profit of associate (15 840 + 76 800)	92 640
Profit before tax	752 640
Income tax expense (P)	(268 000)
PROFIT FOR THE YEAR	484 640
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R484 640
Total comprehensive income attributable to:	
Owners of the parent	384 640
Non-controlling interests	100 000
	R484 640

P LTD GROUP
EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27

	Retained earnings
Balance at 1 January 20.27 (150 000(P) + 40 000(A))	190 000
Changes in equity for 20.27	
Dividends	(50 000)
Total comprehensive income for the year:	
Profit for the year	384 640
Balance at 31 December 20.27 (Test: 400 000(P) + 124 640(A))	R524 640

**Comment**

Take note that the equity method is applied to the consolidated statement of profit or loss and other comprehensive income of A Ltd. In most cases, the consolidated financial statements of A Ltd will be available and can consequently be employed directly in the equity accounting of A Ltd.

Calculations

C1 Analysis of owners' equity of S Ltd

	Total	A Ltd 80%		Non-controlling interests
		At	Since	
i At acquisition (30/6/20.27)				
Share capital	100 000	80 000		20 000
Retained earnings (110 000 + 50 500)	160 500	128 400		32 100
	260 500	208 400		52 100
Investment in S Ltd		(208 400)		
		—		
ii Since acquisition				
• Current year:				
Profit up to 31/12/20.27	49 500		39 600	9 900
Dividends	(10 000)		(8 000)	(2 000)
	R300 000		R31 600	R60 000

C2 Analysis of owners' equity of A Ltd

	Total	P Ltd 40%	
		At	Since
i At acquisition (1/1/20.23)			
Share capital	100 000	40 000	
Retained earnings	20 000	8 000	
	120 000	48 000	
Investment in A Ltd		(50 000)	
Goodwill		(R2 000)	
ii Since acquisition			
• To beginning of current year			
Retained earnings (120 000 – 20 000)	100 000		40 000
• Current year:			
Profit for the year			
S Ltd	39 600		15 840
A Ltd (200 000 – 8 000)	192 000		76 800
Dividends	(20 000)		(8 000)
	R431 600		R124 640

2 The investment in the associate is held by a partially-owned subsidiary

Consider the following group: P Ltd owns 80% of the issued shares of S Ltd, which in turn owns 40% of the issued shares of A Ltd. For the purposes of the preparation of the consolidated statements of P Ltd, S Ltd's interest in A Ltd's owners' equity will be analysed. The analysis is then used to calculate the consolidated owners' equity of S Ltd and to analyse P Ltd's interest therein.

Example 11.10	Investment in associate by a partially-owned subsidiary
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27			
	P Ltd Group	S Ltd	A Ltd
ASSETS			
Property, plant and equipment	220 000	235 000	80 000
Investment in S Ltd (80 000 shares at cost)	80 000	–	–
Investment in A Ltd (40 000 shares at cost)	–	65 000	–
Inventories	200 000	300 000	120 000
Total assets	R500 000	R600 000	R200 000
EQUITY AND LIABILITIES			
Share capital (200 000/100 000/100 000 shares)	200 000	100 000	100 000
Retained earnings	200 000	500 000	100 000
Non-controlling interests	100 000	–	–
Total equity and liabilities	R500 000	R600 000	R200 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27			
	P Ltd Group	S Ltd	A Ltd
Profit	100 000	330 000	85 000
Other income (dividend received)	40 000	4 000	–
Profit before tax	140 000	334 000	85 000
Income tax expense	(40 000)	(134 000)	(35 000)
PROFIT FOR THE YEAR	100 000	200 000	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R100 000	R200 000	R50 000
Total comprehensive income attributable to:			
Owners of the parent	80 000	200 000	50 000
Non-controlling interests	20 000	–	–
	R100 000	R200 000	R50 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27			
	Retained earnings		
	P Ltd Group	S Ltd	A Ltd
Balance at 1 January 20.27	150 000	350 000	60 000
Changes in equity for 20.27			
Dividends paid: 31 December 20.27	(30 000)	(50 000)	(10 000)
Total comprehensive income for the year:			
Profit for the year	80 000	200 000	50 000
Balance at 31 December 20.27	R200 000	R500 000	R100 000

Additional information

- 1 P Ltd acquired 80% of the issued share capital of S Ltd at incorporation of S Ltd.
- 2 S Ltd acquired 40% of the issued share capital of A Ltd on 1 January 20.27. Since the acquisition date, S Ltd has been exercising significant influence over the financial and operating decisions of A Ltd.

Solution 11.10

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (220 000 + 235 000)	455 000
Investment in associate (65 000 + 16 000)	81 000
	536 000
Current assets	
Inventories (200 000 + 300 000)	500 000
Total assets	R1 036 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital: R1 ordinary shares	200 000
Retained earnings	612 800
	812 800
Non-controlling interests (100 000(given) + 123 200(S))	223 200
Total equity	1 036 000
Total equity and liabilities	R1 036 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Profit (100 000 + 330 000)	430 000
Share of profit of associate	20 000
Profit before tax	450 000
Income tax expense (40 000 + 134 000)	(174 000)
PROFIT FOR THE YEAR	276 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R276 000
Total comprehensive income attributable to:	
Owners of the parent	212 800
Non-controlling interests (20 000(given) + 43 200(S))	63 200
	R276 000

P LTD GROUP EXTRACT FROM THE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27	
	Retained earnings
Balance at 1 January 20.27 (150 000(P) + 280 000(S))	430 000
Changes in equity for 20.27	
Dividends	(30 000)
Total comprehensive income for the year:	
Profit for the year	212 800
Balance at 31 December 20.27 (Test: 200 000(P) + 412 800(S))	R612 800

Calculations

C1 Analysis of owners' equity of A Ltd

	Total	S Ltd 40%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	60 000	24 000	
	160 000	64 000	
Investment in A Ltd		(65 000)	
Goodwill		(R1 000)	
ii Since acquisition			
• Current year:			
Profit for the year	50 000		20 000
Dividends	(10 000)		(4 000)
	R200 000		R16 000

C2 Analysis of owners' equity of S Ltd

	Total	P Ltd 80%		Non-controlling interest
		At	Since	
i At acquisition				
Share capital	100 000	80 000		20 000
Investment in A Ltd		(80 000)		
		—		
ii Since acquisition				
• To beginning of current year				
Retained earnings	350 000		280 000	70 000
• Current year				
Profit – S Ltd (200 000 – 4 000)	196 000		156 800	39 200
Equity profit – A Ltd	20 000		16 000	4 000
Dividends	(50 000)		(40 000)	(10 000)
	R616 000		R412 800	R123 200

3 The investment in the associate is held by an associate of the parent

A parent may own shares in an associate which itself also owns shares in another associate. Consider the following group: P Ltd owns 80% of the issued ordinary shares of S Ltd, and also owns 40% of the issued ordinary shares of A Ltd, which in turn owns 30% of the issued ordinary shares of AA Ltd. A mechanical application of the 20% criterion allows P Ltd to use the equity financial statements of A Ltd (i.e. that already includes the investment in AA Ltd in accordance with the equity method) for the purposes of the preparation of consolidated statements. The equity accounting of associates in which the parent owns indirect interests through other associates must be approached with caution, since the influence by the parent over the financial and operating decisions of the eventual associate may be so diluted that equity accounting of the associate is inappropriate.

11.5 Classification as held for sale

If an entity decides to sell an investment in an associate, or a portion of an investment, and it meets the criteria contained in IFRS 5, the investment becomes a non-current asset held for sale, and is accounted for in accordance **with IFRS 5 Non-current Assets Held For Sale and Discontinued Operations** (IAS 28.20).

Refer to paragraph 14.10 for associates classified as held for sale.

11.6 Impairment losses

After equity accounting for the investment, the entity applies the requirements of **IAS 39 Financial Instruments**, to determine whether there is any indication of impairment of the net investment in the associate. The entity also uses IAS 39 to determine whether an additional impairment loss should be recognised for the entity's interest in the associate that does not constitute part of the net investment.

Since goodwill forms part of the carrying amount of the investment in the associate and is not recognised separately, it is not tested separately for impairment in accordance with IAS 36. If, by applying the requirements of IAS 39, there is an indication of possible impairment of the investment in the associate, the entire carrying amount of the investment will be tested for impairment in accordance with IAS 36, by comparing the recoverable amount (greater of value in use and fair value less costs of disposal) to the carrying amount of the investment. The impairment loss is not allocated to any asset, including goodwill, that forms part of the carrying amount of the investment.

In determining the value in use of the investment, an entity estimates:

- ☐ its share of the present value of the estimated future cash flows expected to be generated by the investee as a whole, including the cash flows from the operations of the investee and the proceeds on the ultimate disposal of the investment; or
- ☐ the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from the ultimate disposal of the investment.

The recoverable amount of an investment in an associate is assessed for each individual associate, unless an individual associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the reporting entity (IAS 28.40–42).



Comment

P Ltd acquired a 25% interest in A Ltd on 1 January 20.28 at a cost of R250 000. P Ltd has significant influence over A Ltd.

The carrying amount of the investment was as follows on 31 December 20.29:

Cost of investment	250 000
Share in retained earnings – to 31 December 20.28 ($200\,000 \times 25\%$)	50 000
Share of profit of associate for the year ended 31 December 20.29 ($100\,000 \times 25\%$)	25 000
Carrying amount of the investment	<u>R325 000</u>

The significant decrease in profit for the year ended 31 December 20.29 occurred as a result of a declining market (there are indications of impairment present in respect of the investment). P Ltd's financial advisor estimated that A Ltd will pay an annual dividend of R90 000 to its shareholders in future. A fair dividend return rate for an entity with a similar risk and growth profile is 10%.

The recoverable amount of the investment (25% interest) on 31 December 20.29 is as follows:

Expected annual dividend ($90\,000 \times 25\%$)	R22 500
Fair dividend return rate	10%
Recoverable amount – capitalised dividend ($22\,500/0.10$)	R225 000
The impairment loss on the investment is as follows:	
Carrying amount of investment	325 000
Recoverable amount	(225 000)
Impairment loss (recognised in profit or loss)	<u>R100 000</u>

Journal entry

	Dr	Cr
31 December 20.29		
Impairment loss (P/L)	R100 000	
Investment in associate (SFP)		R100 000

The impairment loss of R100 000 on the investment in the associate is reversed against the investment in the associate in subsequent periods to the extent that the recoverable amount of the investment increases. Assume the recoverable amount increases to R275 000 on 31 December 20.30:

Recoverable amount 20.29	225 000
Recoverable amount 20.30	275 000
Reversal of impairment loss	<u>R50 000</u>

Journal entry

	Dr	Cr
31 December 20.30		
Investment in associate (SFP)	R50 000	
Reversal of impairment loss (P/L)		R50 000

11.7 Discontinuing the use of the equity method

An investor should discontinue the use of the equity method from the date that it ceases to be an associate as follows (IAS 28.22):

- ☐ If the investment becomes a subsidiary, the investment must be accounted for in accordance with **IFRS 3 Business Combinations**, or **IFRS 10 Consolidated Financial Statements**.
- ☐ If the retained interest in the former associate is a financial asset, it must be measured at fair value in accordance with **IFRS 9 Financial Instruments**, which will be deemed its fair value on initial recognition of the financial asset. On the date that an investment ceases to be an associate, the investor will measure the retained investment at fair value. The difference between the following must be recognised in profit or loss:
 - the fair value of the retained interest plus any proceeds from the disposal of the equity accounted investment; and
 - the carrying amount of the equity accounted investment on the date that significant influence was lost.
- ☐ If the equity method is discontinued or if the current interest in the associate is reduced and the entity continues to apply the equity method, all amounts, or a proportionate part thereof, previously recognised in other comprehensive income relating to the investment, will be accounted for on the same basis as would have been required if the related assets or liabilities were disposed of. This means that if an amount that was recognised in other comprehensive income would be reclassified to profit or loss on disposal of the related assets or liabilities, the entity would reclassify the gain or loss from equity via other comprehensive income to profit or loss when the equity method is discontinued.
- ☐ If an investment in an associate becomes an investment in a joint venture or vice versa, the entity will continue to apply the equity method and retained earnings will not be remeasured.

11.8 Disclosure

The disclosure requirements for joint arrangements and associates are set out in **IFRS 12 Disclosure of Interests in Other Entities** (IFRS 12.20–23) (refer to chapter 12 for joint arrangements).

An entity is required to disclose information that will enable users of financial statements to evaluate the nature, extent and financial effects of its interests in associates, including the nature and effect of its contractual relationship with other investors with significant influence, as well as the nature of and changes in the risks associated with its interests in associates.

An entity must disclose information about significant adjustments and assumptions made in determining if the entity has significant influence over another entity (this may also include disclosure of assumptions and judgements made to determine that no significant influence is exercised, although the entity holds more than 20% of the voting rights of the investee, or vice versa, where an investor does exercise significant influence, although it holds less than 20% of the voting rights).

The following information must be disclosed separately for each associate that is **material** to the reporting entity:

- ☐ the name of the associate;
- ☐ the nature of the entity's relationship with the associate;
- ☐ the principal place of business (and country of incorporation, if applicable or different); and
- ☐ the proportion of ownership interest or participating share and if different, the proportion of voting rights held.

The following information must be disclosed for every associate that is **material** to the reporting entity:

- ☐ whether the investment in the associate is measured using the equity method or at fair value;
- ☐ summarised financial information of the associate (obtained from the financial statements, the total amount and not only the investor's share thereof), including dividends received, non-current and current assets, non-current and current liabilities, revenue, profit or loss from continuing and discontinued operations, other comprehensive income and total comprehensive income;
- ☐ if the equity method is applied, the fair value of investments in associates for which there are published price quotations;
- ☐ if the equity method is applied, the amounts in the financial statements of the associate must be adjusted by fair value adjustments at acquisition and adjustments for differences in accounting policy;
- ☐ if the equity method is applied, a reconciliation must be provided between the summarised financial information and the carrying amount of the interest in the associate; and
- ☐ if the interest is measured at fair value or if the associate does not prepare IFRS financial statements, the summarised financial information may be prepared on the basis of the associate's financial statements.

The following information must be disclosed for associates which are individually **immaterial** to the reporting entity (it must be disclosed in total for all associates which are individually immaterial):

- ☐ the carrying amount in total of all individually immaterial associates that were equity accounted for; and
- ☐ summarised financial information of the associate, including profit or loss from continuing and discontinued operations, other comprehensive income and total comprehensive income.

The following must also be disclosed:

- ☐ the nature and extent of any significant restrictions on the associate's ability to transfer funds to the entity;
- ☐ if the reporting periods of the entity and the associate differ, the reporting period of the associate should be mentioned, as well as the reason for the use of different reporting periods;

- ☐ the unrecognised share of losses of an associate, both for the current period and cumulatively;
- ☐ any contingent liabilities incurred relating to interests in associates in accordance with **IAS 37 Provisions, Contingent Liabilities and Contingent Assets**, which must be separately disclosed.

Piecemeal acquisition of interest in investees

11.9 Changes in ownership interest

1 Acquisition of additional shares whereby the investee becomes an associate

Where the equity method is applied for the first time, since significant influence has now been secured, for instance because of the acquisition of additional shares or the conclusion of a shareholders' agreement, the investor's share of since acquisition equity (i.e. profit or loss) is accounted for as follows:

- ☐ The investor's share of the retained earnings (i.e. profit or loss) of the associated company, from the date on which the investee becomes an associate, is included in the current period's profit or loss in the investor's financial statements as **share of profit of associate**.

Example 11.11	Piecemeal acquisition whereby the status of an investment changes to that of an associate (significant influence is obtained)
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On 31 December 20.23, the following information relating to P Ltd and A Ltd is available:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.23		
	P Ltd and subsidiaries (consolidated)	A Ltd
ASSETS		
Property, plant and equipment	250 000	150 000
Investment in A Ltd	235 500	–
Inventory	487 500	450 000
Total assets	R973 000	R600 000
EQUITY AND LIABILITIES		
Share capital (250 000/100 000 shares)	250 000	100 000
Mark-to-market reserve	57 232	–
Retained earnings	600 000	500 000
Non-controlling interests	50 000	–
Deferred tax	15 768	–
Total equity and liabilities	R973 000	R600 000

EXTRACT FROM STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.23		
	P Ltd and subsidiaries (consoli- dated)	A Ltd
Revenue	800 000	300 000
Cost of sales	(300 000)	(150 000)
Income tax expense	(50 000)	(30 000)
PROFIT FOR THE YEAR	450 000	120 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Fair value adjustment on investment	5 880	–
Other comprehensive income for the year, net of tax	5 880	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R455 880	R120 000
Profit attributable to:		
Owners of the parent	400 000	120 000
Non-controlling interests	50 000	–
	R450 000	R120 000
Total comprehensive income attributable to:		
Owners of the parent	405 880	120 000
Non-controlling interests	50 000	–
	R455 880	R120 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.23		
	Retained earnings	
	P Ltd and subsidiaries (consoli- dated)	A Ltd
Balance at 1 January 20.23	300 000	380 000
Changes in equity for 20.23		
Total comprehensive income for the year:		
Profit for the year	400 000	120 000
Dividends	(100 000)	–
Balance at 31 December 20.23	R600 000	R500 000

Additional information

- 1 P Ltd acquired 15% of A Ltd's issued share capital on 31 December 20.22 for R15 000. This interest did not enable P Ltd to exercise significant influence over A Ltd.
- 2 P Ltd acquired a further 25% of A Ltd's issued share capital for R147 500 on 30 November 20.23, from which date P Ltd exercised significant influence over the financial and operating decisions of A Ltd. The fair value of the previously held 15% interest on this date was R88 000.
- 3 A Ltd's profit was earned evenly throughout the period.
- 4 P Ltd classified the investment in A Ltd at cost after it became an associate. Before A Ltd became an associate, P Ltd classified the investment under IFRS 9 in its separate financial statements and recognised all fair value adjustments on the investment in A Ltd through other comprehensive income using a mark-to-market reserve. The cumulative fair value gain on 1 January 20.23 amounted to R65 500.
- 5 On each date of purchase, the identifiable assets and liabilities of A Ltd were regarded to be fairly valued.
- 6 Assume a company tax rate of 27% and that capital gains tax is recognised at 80% thereof.

Solution 11.11

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.23	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	250 000
Investment in associate (88 000 + 147 500 + 500 + 4 000)	240 000
	490 000
Current assets	
Inventory (P)	487 500
Total assets	R977 500
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	250 000
Retained earnings	661 732
	911 732
Non-controlling interests (P)	50 000
Total equity	961 732
Liabilities	
Deferred tax	15 768
Total liabilities	15 768
Total equity and liabilities	R977 500

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.23	
Revenue	800 000
Cost of sales	(300 000)
Gross profit	500 000
Share of profit of associate (4 000 + 500)	4 500
Profit before tax	504 500
Income tax expense	(50 000)
PROFIT FOR THE YEAR	454 500
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Fair value adjustment on investment (88 000 – (15 000 + 65 500) = 7 500 – (7 500 × 27% × 80%))	5 880
Other comprehensive income for the year, net of tax	5 880
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R460 320
Profit attributable to:	
Owners of the parent	404 500
Non-controlling interests (other subsidiaries)	50 000
	454 500
Total comprehensive income attributable to:	
Owners of the parent	410 380
Non-controlling interests (other subsidiaries)	50 000
	R460 380

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.23						
	Share capital	Retained earnings	Mark-to-market reserve	Total	Non-controlling interests	Total equity
Balance at 1 January 20.23	250 000	300 000	*51 352	601 352	# –	601 352
Changes in equity for 20.23						
Dividends	–	(100 000)		(100 000)	–	(100 000)
Total comprehensive income for the year:						
Profit for the year	–	404 500	5 880	410 380	50 000	460 380
Transfers		57 232	(57 232)			
Balance at 31 Dec 20.23	R250 000	R661 732	–	R911 732	R50 000	R961 732

50 000 – 50 000 (current year) = Nil

* 65 500 (given) – (65 500 × 27% × 80%) = 51 352

Calculations**C1 Analysis of owners' equity in A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition of additional interest			
Share capital	100 000	40 000	
Retained earnings ((500 000 – (120 000/12))	490 000	196 000	
	590 000	236 000	
Gain from a bargain purchase		(500)	
Consideration (88 000 + 147 500)		R235 500	
ii Since acquisition			
Current year:			
Profit: 1/12/20.23–31/12/20.23 (1)	10 000		4 000
	R600 000		R4 000

(1) $120\,000 \times 1/12 = 10\,000$ (accrued evenly)

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Mark-to-market reserve (SCE) Retained earnings (SCE) Fair value gain realised at deemed disposal of investment when obtain significant influence	57 232	57 232
J2	Investment in A Ltd (SFP) Share of profit of associate (P/L) Recognise gain from a bargain purchase	500	500
J3	Investment in A Ltd (SFP) Share of profit of associate (P/L) Equity accounting of the investment in A Ltd at group level	4 000	4 000

2 Accounting for other changes in the net assets of an associate

The current version of IAS 28 **Investments in Associates and Joint Ventures** does not specifically address **other changes in the net assets** of an investee (e.g. issuing of new shares). The standard only stipulates the treatment of items in profit or loss, and other comprehensive income of the associate or joint venture under the equity method.

In June 2022, the IASB was still busy with its “Equity Method Project” (refer to IASB Update June 2022) and no final decision was made at the time this publication was finalised. The IASB is specifically considering the accounting treatment for:

- ☐ Purchase of an additional interest and disposal of an interest in an associate, while retaining significant influence; and
- ☐ Other changes in an associate’s net assets (rights issues, buy-back of shares, share issues under share-based payments, etc. may arguably fall under such other changes).

Disposal of interests in an investee

2 Disposal of the entire interest in an associate

The same principles apply when significant influence over an associate, or joint control over a jointly controlled entity, is relinquished. The example hereafter deals with an associate where IAS 28.18 is applicable. The total interest in the associate is disposed of and the retained investment in the former associate is therefore carried at Rnil.

Example 11.12	Disposal of the entire interest in an associate (significant influence is lost)
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P Ltd acquired 40% of the issued share capital of A Ltd on 1 January 20.23 for R50 000, when the retained earnings of A Ltd amounted to R10 000. P Ltd exercised significant influence over the financial and operating policies of A Ltd from that date. On 30 June 20.27, P Ltd disposed of its entire interest in A Ltd for R66 000. A Ltd’s profit after tax for the six months ended 30 June 20.27 amounted to R25 000.

The disposal of the interest in the associate did not comply with the requirements of **IFRS 5 Non-current Assets Held for Sale and discontinued operations** up to the date of disposal of the interest. P Ltd measures investments in associates at cost in its separate financial statements. Ignore taxation.

Solution 11.12**STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27**

	P Ltd and sub- sidiaries (consoli- dated)	A Ltd
ASSETS		
Property, plant and equipment	400 000	100 000
Inventory	100 000	150 000
Total assets	R500 000	R250 000
EQUITY AND LIABILITIES		
Share capital (200 000/100 000 shares)	200 000	100 000
Retained earnings	200 000	150 000
Non-controlling interests	100 000	—
Total equity and liabilities	R500 000	R250 000

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.27**

	P Ltd and sub- sidiaries (consoli- dated)	A Ltd
Revenue	300 000	200 000
Cost of sales	(112 000)	(100 000)
Gross profit	188 000	100 000
Other income (gain on disposal of shares)	16 000	—
Profit before tax	204 000	100 000
Income tax expense	(94 000)	(50 000)
PROFIT FOR THE YEAR	110 000	50 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R110 000	R50 000
Total comprehensive income attributable to:		
Owners of the parent	80 000	50 000
Non-controlling interests	30 000	—
	R110 000	R50 000

EXTRACT FROM STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd and subsidiaries (consolidated)	A Ltd
Balance at 1 January 20.27	150 000	125 000
Changes in equity for 20.27		
Total comprehensive income for the year:		
Profit for the year	80 000	50 000
Dividends (31 December 20.27)	(30 000)	(25 000)
Balance at 31 December 20.27	R200 000	R150 000

The pro forma consolidation journal entry will be as follows:

		Dr R	Cr R
J1	Gain on disposal of interest (P/L) (C2) (Reverse P Ltd's gain on disposal)	16 000	
	Loss on disposal of interest (P/L) (C2) (establish loss in group context)	40 000	
	Share of profit of associate (P/L) (C1)		10 000
	Retained earnings – Beginning of period (SCE) (C1)		46 000
	Gain correction at group level and equity accounting of associate		

Calculations

C1 Analysis of owners' equity in A Ltd

	Total	P Ltd 40%–0%	
		At	Since
i At acquisition			
Share capital	100 000	40 000	
Retained earnings	10 000	4 000	
	110 000	44 000 (50 000)	
Investment in A Ltd			
ii Since acquisition			
• To beginning of current year:			
Retained earnings (125 000 – 10 000)	115 000		46 000
• Current year:			
Profit: 1/1/20.27–30/6/20.27 (given)	25 000		10 000
	250 000		56 000 (56 000)
Disposal of entire interest		(44 000)	
	R250 000		–

C2 Calculation of gain/(loss) on disposal of interest in associate

Proceeds on disposal of interest	66 000
Historic cost of interest disposed of	(50 000)
Gain on disposal in P Ltd's separate records (66 000 – 50 000)	16 000
Since acquisition reserves disposed of	
Retained earnings (46 000 + 10 000)	(56 000)
Loss on disposal of interest in group context	(R40 000)
The calculation can also be done as follows (IAS 28.22(b)):	
Proceeds on disposal of interest	66 000
Fair value	N/A
Carrying amount on date of disposal (50 000 + 56 000(*))	(106 000)
Loss on disposal of interest in group context	(R40 000)

(*) The R56 000 represents P Ltd's interest in the since acquisition reserves of A Ltd by which the investment in A Ltd has been adjusted upwards in terms of the equity method.

	Comments The gain from the disposal of interest of R16 000 according to the separate records of P Ltd is therefore effectively replaced, on applying the equity method, by a loss on disposal of interest of R40 000 (i.e. R16 000 – R56 000).
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3 Partial disposal of an interest in an associate

- ☐ If the retained interest in the former associate is a financial asset, it must be measured at fair value, which will be deemed its fair value on initial recognition of the financial asset, in accordance with **IFRS 9 Financial Instruments**.
- ☐ On the date that an investment ceases to be an associate, the investor will measure the retained investment at fair value. The difference between:
 - the fair value of the retained interest plus any proceeds from the disposal of the equity accounted investment; and
 - the carrying amount of the equity accounted investment on the date that significant influence was lost, must be recognised in profit or loss.
- ☐ If the equity method is discontinued or if the current interest in the associate is reduced and the entity continues to apply the equity method, all amounts, or a proportionate part thereof relating to the investment previously recognised in other comprehensive income will be accounted for on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities (IAS 28.22(c)). This means that if an amount that was recognised in other comprehensive income would be reclassified to profit or loss on disposal of the related assets or liabilities, the entity would reclassify the gain or loss from equity via other comprehensive income to profit or loss when the equity method is discontinued.

Example 11.13	Partial disposal of an interest in an associate – Loss of significant influence (associate becomes IFRS 9 investment)
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EXTRACT OF STATEMENTS OF FINANCIAL POSITION OF A LTD				
	01/01/20.24	31/12/20.25	30/06/20.26	31/12/20.26
EQUITY AND LIABILITIES				
Share capital	600 000	600 000	600 000	600 000
Retained earnings	180 000	270 000	315 000	360 000
Revaluation surplus	225 000	276 600	276 600	276 600
Mark-to-market reserve	258 000	296 700	309 600	335 400
Total equity and liabilities	R1 263 000	R1 443 300	R1 501 200	R1 572 000

Additional information

- P Ltd acquired 40% of the issued share capital of A Ltd on 1 January 20.24 for R525 000. P Ltd exercised significant influence over the financial and operating policies of A Ltd from that date.
- On 30 June 20.26, P Ltd disposed of a 35% interest in A Ltd for R615 000. The remaining 5% interest had a fair value of R112 500 on 30 June 20.26 and R165 000 on 31 December 20.26. A Ltd classified the investment as a financial asset at fair value through other comprehensive income.
- A Ltd's profit after tax for the six months ended 30 June 20.26 amounted to R45 000 (earned evenly during the year).
- P Ltd measures investments in associates at cost in its separate financial statements.
- The revaluation surplus relates to land. It is the policy of P Ltd to realise the revaluation surplus on the disposal of the land. The mark-to-market reserve relates to fair value gains on financial assets at fair value through other comprehensive income. It is the policy of P Ltd to transfer these gains to retained earnings on the disposal of the financial assets.
- P Ltd included the following items in its separate financial statements for 20.26:
 - ☐ Financial asset at fair value through other comprehensive income R165 000;
 - ☐ Gain on disposal of investment in associate R155 625 (615 000 – (525 000 × 35/40));
 - ☐ Mark-to-market reserve R52 500 (165 000 – 112 500);
 - ☐ Day one gain (P/L) R46 875 ((112 500 – (525 000 × 5/40)).
- Ignore taxation.

Solution 11.13

The pro forma consolidation journal entries will be as follows:

		Dr R	Cr R
J1	Investment in A Ltd (SFP) Retained earnings (SCE) Revaluation surplus (SCE) Mark-to-market reserve (SCE) Recognition of opening equity	72 120	36 000 20 640 15 480
J2	Investment in A Ltd (SFP) Share of profit of associate (P/L) Share of other comprehensive income of associate (OCI) Recognition of profit and other comprehensive income (01/01/20.26–30/06/20.26)	23 160	18 000 5160
J3	Gain on sale of shares (separate) (P/L) Gain on sale of shares (consolidated) (P/L) Investment in A Ltd (SFP) Recognition of consolidated gain on disposal of 35% interest in associate	155 625	72 255 83 370
J4	Revaluation surplus (SCE) Mark-to-market reserve (SCE) Retained earnings (SCE) Transfer to retained earnings on date of disposal	20 640 20 640	41 280
J5	Gain on mark-to-market reserve (OCI) (given) Day one gain (P/L) Investment in A Ltd (SFP) Elimination of mark-to-market adjustment in separate financial statements	52 500 46 875	99 375
J6	Investment in A Ltd (SFP) (C1) Fair value adjustment (P/L) Fair value adjustment for the group on 30 June 20.26	34 965	34 965
J7	Investment in A Ltd (SFP) (165 000 – 112 500) Gain on mark-to-market reserve (OCI) Fair value adjustment for the group on 31 December 20.26	52 500	52 500

Calculations

C1 Analysis of owners' equity in A Ltd

	Total	P Ltd 40%–35%		
		At	Since (RE)	(MtM;RS)
i At acquisition (01/01/20.24)				
Share capital	600 000	240 000		
Retained earnings	180 000	72 000		
Revaluation surplus	225 000	90 000		
Mark-to-market reserve	258 000	103 200		
	1 263 000	505 200		
Goodwill		19 800		
Consideration		525 000		
ii Since acquisition				
• To beginning of current year				
Retained earnings (1)	90 000		36 000	
Revaluation surplus (2)	51 600			20 640 RS
Mark-to-market reserve (3)	38 700			15 480 MtM
• Current year (20.26)				
Profit: 1/1/20.26–30/6/20.26 (4)	45 000		18 000	
Mark-to-market reserve (5)	12 900			5 160 MtM
	1 501 200	525 000	54 000	20 640 RS
Disposal of 35% (8);(C2)		(459 375)	(83 370)	20 640 MtM
Transfer to retained earnings			20 640	(20 640) RS
Transfer to retained earnings			20 640	(20 640) MtM
	R1 501 200	*R65 625	*R11 910	–

(1) (270 000 – 180 000);

(2) (276 600 – 225 000)

(3) (296 700 – 258 000);

(4) (315 000 – 270 000)

(5) (309 600 – 296 700);

(6) (360 000 – 315 000)

(7) (335 400 – 309 600);

(8) (525 000 × 35/40)

* **Carrying amount of remaining interest:** 65 625 + 11 910 = 77 535

Fair value adjustment: Fair value – Carrying amount = 112 500 – 77 535 = 34 965

C2 Calculation of gain/(loss) on disposal of interest in associate

Proceeds on disposal of interest	615 000
Cost of interest disposed of (525 000 × 35/40)	(459 375)
Gain on disposal in P Ltd's separate records	155 625
Less: Since acquisition reserves disposed of ((1 501 200 – 1 263 000) × 35%)	83 370
Gain on disposal of interest (group context)	R72 255
The calculation can also be done as follows:	
Proceeds on disposal of interest	615 000
Consolidated net asset value (1 501 200 × 35%)	(525 420)
Goodwill (19 800 × 35/40)	(17 325)
Gain on disposal of interest (group context)	R72 255

Self-assessment questions

Question 11.1	Basic equity accounting/interest received
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The profit-or-loss section of the draft consolidated statements of profit or loss and other comprehensive income and an extract from the consolidated statements of changes in equity of P Ltd and its subsidiaries and A Ltd and subsidiaries for the 20.27 financial year are as follows:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	A Ltd Group
Revenue	5 873 000	1 857 000
Cost of sales	(4 600 000)	(1 539 000)
Gross profit	1 273 000	318 000
Interest received	15 000	–
Gain from sale of land	–	100 000
Dividends received	14 000	–
Interest paid	–	(30 000)
Profit before tax	1 302 000	388 000
Income tax expense		
Current	(390 000)	(106 000)
Deferred	(90 000)	(34 000)
PROFIT FOR THE YEAR	822 000	248 000
Profit attributable to:		
Owners of the parent	798 000	218 000
Non-controlling interests	24 000	30 000
	R822 000	R248 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	A Ltd Group
Balance at 1 January 20.27	1 149 000	242 000
Changes in equity for 20.27		
Dividends paid	(235 000)	(56 000)
Total comprehensive income for the year:		
Profit for the year	798 000	218 000
Balance at 31 December 20.27	R1 712 000	R404 000

Additional information

- 1 A Ltd's issued share capital consists of 150 000 shares of R1 each. The company is situated in Cape Town.
- 2 A Ltd revalues its buildings annually on 31 August. The revaluation surplus (after tax at 27%) had arisen as follows:

31 August 20.25	20 000
31 August 20.26	20 000
31 August 20.27	10 000
	R50 000
- 3 On 1 September 20.25, P Ltd acquired 22 500 shares in A Ltd, a manufacturer of musical instruments, for R50 000, when A Ltd's consolidated retained earnings amounted to R100 000. Since 1 September 20.25, P Ltd also has an option to take up another 10 000 shares in A Ltd. The option has been exercisable at any time since 1 September 20.25, but P Ltd has not exercised it as of yet. On 31 December 20.27, the shares in A Ltd traded at R4,10.
- 4 On 1 September 20.25, A Ltd issued R100 debentures to the amount of R150 000. At this date, half of the debentures were taken up by P Ltd; the other half was taken up by other shareholders. The interest received and paid by P Ltd and A Ltd respectively relates to these debentures. The debentures bear a market-related interest rate.
- 5 The profit from sale of land relates to a farm sold by A Ltd to P Ltd. It was a transaction negotiated under extreme conditions and the profit is of a capital nature.
- 6 Included in P Ltd's profit before tax are the following items:

Secretarial services rendered by an external person	R20 000
Directors' remuneration – for services as directors	R100 000
- 7 The carrying amounts of A Ltd's assets and liabilities as at 31 December 20.27 are the following:

Non-current assets	R1 561 100
Current assets	R438 900
Non-current liabilities	R1 300 000
Current liabilities	R96 000
- 8 Assume a normal tax rate of 27% and that 80% of capital gains are taxable.
- 9 The balance of non-controlling interests in the P Ltd Group's consolidated statement of financial position as at 31 December 20.26 amounted to R110 000.

Required

- (a) Prepare the consolidated statement of profit or loss and other comprehensive income and consolidated statements of changes in equity of the P Ltd Group for the year ended 31 December 20.27;
- (b) Indicate the components that the carrying amount of the investment in associate on 31 December 20.27 are compiled of; and
- (c) Prepare the following notes in the consolidated financial statements of the P Ltd Group for the year ended 31 December 20.27 (ignore comparative amounts):
 - ☐ Profit before tax;
 - ☐ Investment in associate.

Suggested solution 11.1**Part (a)**

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (P)	5 873 000
Cost of sales (P)	(4 600 000)
Gross profit	1 273 000
Other income (14 000 + 15 000 – 8 400)	20 600
Share of profit of associate (32 700(C1) – 15 000 + 3240(C2))	20 940
Profit before tax	1 314 540
Income tax expense	
Current (P)	(390 000)
Deferred (P)	(90 000)
PROFIT FOR THE YEAR	834 540
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	1 500
Other comprehensive income for the year, net of tax	1 500
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R836 040
Profit attributable to:	
Owners of the parent	810 540
Non-controlling interests	24 000
	R834 540
Total comprehensive income attributable to:	
Owners of the parent	812 040
Non-controlling interests	24 000
	R836 040

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27				
	Retained earnings	Revaluation surplus	Non-controlling interests	Total
Balance at 1 January 20.27	# 1 170 300	3 000	110 000	1 283 300
Changes in equity for 20.27				
Dividends (P)	(235 000)	–	–	(235 000)
Total comprehensive income for the year:				
Profit for the year	810 540	–	24 000	834 540
Other comprehensive income	–	1 500	–	1 500
Balance at 31 December 20.27	* R1 745 840	@ R4 500	R134 000	R1 884 340

1 149 000(P) + 21 300(C1) = 1 170 300

* Test: 1 712 000(P) + 45 600(C1) – 15 000 + 3 240(C2) = 1 745 840

@ Test: 0(P) + 4 500(C1) = 4 500

Part (b)

Investment in associate

The carrying amount of the investment is compiled as follows:

☐ Cost	50 000
☐ Cumulative since acquisition equity	50 100
- Retained earnings to beginning of the current year - Profit for the current year (32 700 – 8 400) - Revaluation surplus	21 300 24 300 4 500
	# R100 100

Test: 50 000(cost) + 45 600(retained earnings C1) + 4 500(revaluation surplus C1) = 100 100

Part (c)

1 Profit before tax

Profit before tax is stated after taking into account the following expenses:

☐ Secretarial services	R20 000
☐ Directors' remuneration – for services as director	R100 000

2 Investment in associate

P Ltd owns a 15% interest in the manufacturing company, A Ltd. A Ltd is incorporated in South Africa and its principal place of business is Cape Town. The interest is equity accounted for.

Summarised financial information of associate	R
Non-current assets	1 561 100
Current assets	438 900
Non-current liabilities	1 300 000
Current liabilities	96 000
Revenue	1 857 000
Profit for the year	248 000
Other comprehensive income	10 000
Total comprehensive income	258 000

Reconciliation to the carrying amount of the investment

Net assets of associate	604 000
15% interest in net assets of associate	90 600
Plus: Goodwill at acquisition	9 500
Carrying amount of investment in associate	100 100

Fair value of investment in associate

The fair value of the investment in the associate is R92 250
(R4,10 × 22 500 shares)

Calculations

C1 Analysis of owners' equity of A Ltd

	Total	P Ltd 15%	
		At	Since
i At acquisition (1/9/20.25)			
Share capital	150 000	22 500	
Retained earnings	100 000	15 000	
Revaluation surplus	20 000	3 000	
	270 000	40 500	
Investment in A Ltd		(50 000)	
Goodwill		(R9 500)	
ii Since acquisition			
• To beginning of current year:			
Revaluation surplus	20 000		3 000
Retained earnings (242 000 – 100 000)	142 000		21 300
• Current year:			
Revaluation surplus	10 000		1 500
Profit for the year	218 000		32 700
Dividends	(56 000)		(8 400)
	R604 000		45 600 RE
			4 500 RS

C2 Journals in respect of unrealised profit

		Dr R	Cr R
J1	Share of profit of associate (P/L) Land (SFP) ($100\,000 \times 15\% = 15\,000$)	15 000	15 000
J2	Deferred tax (SFP) ($15\,000 \times 27\% \times 80\%$) Share of profit of associate (P/L)	3 240	3 240

Question 11.2	Basic equity accounting/reporting dates differ
----------------------	---

On 1 January 20.23, P Ltd purchased 40% of the issued share capital of A Ltd for R65 000. On this date, the retained earnings of R70 000 were the only reserve of A Ltd. Except for land, which was undervalued by R5 000, all the assets of A Ltd were fairly valued. A Ltd's share capital consisted of 100 000 shares of R1 each. P Ltd exercises significant influence over the financial and operating decisions of A Ltd.

The following represents the statements of profit or loss and other comprehensive income and an extract from the statements of changes in equity of the two companies for the relevant periods:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME		
	P Ltd Group 31/12/20.27	A Ltd 30/9/20.27
Revenue	1 000 000	850 000
Cost of sales	(880 000)	(710 000)
Gross profit	120 000	140 000
Other income (dividend received)	8 000	–
Profit before tax	128 000	140 000
Income tax expense	(60 000)	(70 000)
PROFIT FOR THE YEAR	68 000	70 000
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Revaluation of land	–	10 000
Income tax relating to other comprehensive income	–	(2 160)
Other comprehensive income for the year, net of tax	–	7 840
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R68 000	R77 840
Profit attributable to:		
Owners of the parent	63 000	70 000
Non-controlling interests	5 000	–
	R68 000	R70 000
Total comprehensive income attributable to:		
Owners of the parent	63 000	77 840
Non-controlling interests	5 000	–
	R68 000	R77 840

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY		
	Retained earnings	
	P Ltd Group 31/12/20.27	A Ltd 30/9/20.27
Balance at 1 January 20.27	260 000	150 000
Changes in equity for 20.27		
Dividends paid (30 June 20.27)	(15 000)	(20 000)
Total comprehensive income for the year:		
Profit for the year	63 000	70 000
Balance at 31 December 20.27	R308 000	R200 000

Additional information

- 1 The reporting date of P Ltd is 31 December and that of A Ltd is 30 September.
- 2 Since the acquisition date, the investment in A Ltd has been accounted for according to the equity method in the consolidated financial statements.
- 3 The revaluation surplus arose during June 20.27 when A Ltd revalued its land.
- 4 During November 20.27, A Ltd suffered a loss of R30 000 when a warehouse burned down. This is regarded as a significant event.
- 5 The balance of non-controlling interests in the P Ltd Group's consolidated statement of financial position as at 31 December 20.26 amounted to R75 000.
- 6 Assume a normal tax rate of 27% and that 80% of capital gains are taxable.

Required

- (a) Prepare the consolidated statement of profit or loss and other comprehensive income and consolidated statement of changes in equity of the P Ltd Group which account for the results of A Ltd according to the equity method; and
- (b) Calculate the investment in the associate as it will appear in the consolidated statement of financial position at 31 December 20.27. Also show the compilation thereof.

Suggested solution 11.2

Part (a)

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (P)	1 000 000
Cost of sales (P)	(880 000)
Gross profit	120 000
Share of profit of associate (C1)	16 000
Profit before tax	136 000
Income tax expense (P)	(60 000)
PROFIT FOR THE YEAR	76 000
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Share of other comprehensive income of associate	1 568
Other comprehensive income for the year, net of tax	1 568
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R77 568
Profit attributable to:	
Owners of the parent	71 000
Non-controlling interests	5 000
	R76 000
Total comprehensive income attributable to:	
Owners of the parent	72 568
Non-controlling interests	5 000
	R77 568

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27				
	Retained earnings	Revaluation surplus	Non-controlling interests	Total
Balance at 1 January 20.27	# 296 568	–	75 000	371 568
Changes in equity for 20.27				
Dividends (P)	(15 000)	–	–	(15 000)
Total comprehensive income for the year:				
Profit for the year	71 000	–	5 000	76 000
Other comprehensive income	–	1 568	–	1568
Balance at 31 December 20.27	* R352 568	R1 568	R80 000	R434 136

260 000(P) + 32 000 + 4 568(C1) = 296 568

* 308 000(P) + 40 000 + 4 568(C1) = 352 568

Part (b)**Investment in associate**

The carrying amount of the investment in associate is compiled as follows:

☐ Cost	65 000
☐ Cumulative since acquisition equity	46 136
- Retained earnings to beginning of the current year (32 000 + 4568) - Profit for the current year (16 000 – 8 000) - Revaluation surplus	36 568 8 000 1 568
	# R111 136

Test: 65 000(cost) + 40 000(retained earnings C1) + 1 568(revaluation surplus C1) + 4 568 (bargain purchase C1) = 111 136

Calculation**C1 Analysis of owners' equity of A Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition (1/1/20.23)			
Share capital	100 000	40 000	
Retained earnings	70 000	28 000	
Revaluation surplus (2)	3 920	1 568	
	173 920	69 568	
Investment in A Ltd		(65 000)	
Gain from a bargain purchase		R4 568	
ii Since acquisition			
• To beginning of current year:			
Retained earnings (1)	80 000		32 000
• Current year:			
Profit for the year (70 000 – 30 000)	40 000		16 000
Revaluation surplus (3)#	3 920		1 568
Dividends	(20 000)		(8 000)
	R277 840		R40 000 RE
			R1 568 RS

(1) 150 000 – 70 000 = 80 000

(2) 5 000 – (5 000 × 27% × 80%) = 3 920

(3) (10 000 – 5 000 #) = 5 000 – (5 000 × 27% × 80%) = 3 920

A Ltd revalued its land by R10 000 in its own financial statements, but P Ltd had already revalued the land of A Ltd by R5 000 at date of acquisition of the interest in A Ltd.

12

Interests in joint arrangements

Basic concepts

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Basic concepts

12.1 Description of basic concepts

IFRS 11 Joint Arrangements focuses on investments where an investor can **exercise joint control**, in contrast to control that is established between a parent and a subsidiary in terms of **IFRS 10 Consolidated Financial Statements**.

A **joint arrangement** is an arrangement where two or more parties exercise joint control that is the contractually agreed sharing of control. This means that the unanimous consent of the parties sharing control is required for all decisions about the relevant activities.

A joint arrangement is classified as follows:

- ☐ assess if collective control of an arrangement exists; and
- ☐ then assess if the contractual arrangement gives two or more parties joint control.

Collective control of an arrangement exists when all the parties must act together to direct the activities that significantly affect the returns of the arrangement. If collective control exists, it must be assessed whether joint control exists.

Joint control is the contractually agreed sharing of control over an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. An entity must assess whether all the parties have joint control of the arrangement. No single party can control the arrangement individually.

Control is not defined in IFRS 11. In accordance with **IFRS 10 Consolidated Financial Statements** an investor controls an investee when it is exposed or has rights to variable returns from its involvement with that investee and has the ability to affect those returns through its power of the investee.

An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. Therefore, there are parties exercising joint control of an arrangement and other parties participating in the arrangement. An entity must apply its judgement to assess whether all of the parties jointly control an arrangement.

12.2 Types of joint arrangements

A **joint arrangement** is an arrangement of which two or more parties have joint control. IFRS 11 identifies two types of joint arrangements: a **joint operation** and a **joint venture**. The following characteristics are present in both:

- ☐ two or more parties are bound by a contractual arrangement; and
- ☐ the contractual arrangement establishes joint control.

A **contractual arrangement** is often in writing in the form of a formal contract or minutes of discussions between parties. When the joint arrangement is structured through a separate vehicle, the contractual arrangement or some aspects thereof will be incorporated in the articles, charter or by-laws of this entity. A separate vehicle is a separately identifiable financial structure, including separate legal entities or entities

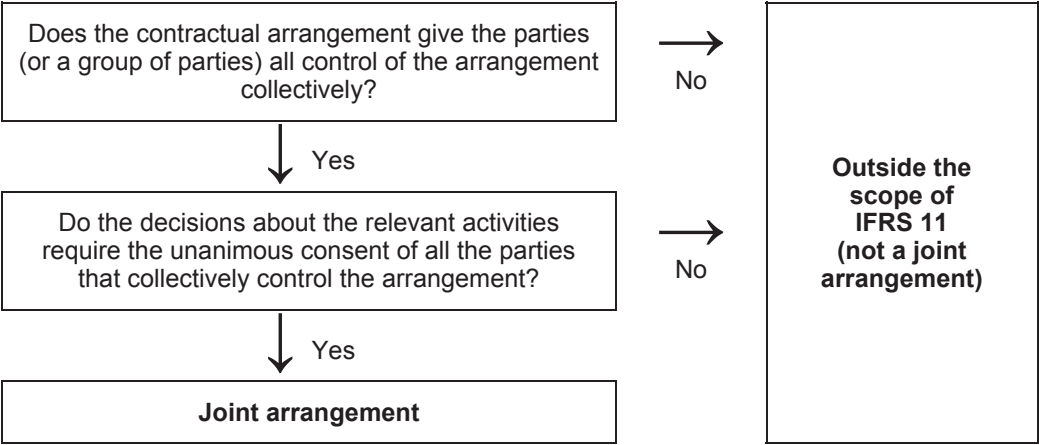
recognised by statute, regardless of whether those entities have a legal personality. The contractual arrangement deals with the following:

- ☐ the purpose, activities and duration of the joint arrangement;
- ☐ the appointment of the board of directors or similar governing body of the joint arrangement;
- ☐ the decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. This process establishes joint control of the arrangement;
- ☐ capital or other contributions required of the parties; and
- ☐ the sharing of production, revenues, expenses or profit or loss of the joint arrangement.

A **joint operation** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement. Those parties are called joint operators.

A **joint venture** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

Is it a joint arrangement?



Classification of joint arrangements

The classification of a joint arrangement depends upon the rights and obligations of the parties to the arrangement. An entity must consider the following in order to classify a joint arrangement:

- ☐ the structure of the joint arrangement;
- ☐ when a joint arrangement is structured through a separate vehicle:
 - the legal form of the separate entity;
 - the terms of the contractual arrangement; and
 - other facts and circumstances, if applicable.

Sometimes a framework agreement exists that contains the general terms for one or more activities, which sets out that the parties establish different joint arrangements for specific activities that form part of the same agreement. Even though those joint arrangements are governed under the same framework agreement, they may be classified as different types of arrangements if the rights and obligations differ. Therefore, joint operations and joint ventures can co-exist when different activities are undertaken by the parties that form part of the same framework agreement.

12.3 Structure of the joint arrangement

Joint arrangements can either be structured through a separate vehicle, or not.

A joint arrangement which is not structured through a separate vehicle can only be classified as a joint operation. In such cases the contractual arrangement establishes the rights and obligations of the parties, for example, where the parties agree to manufacture a product together, with each party being responsible for a specific task by using its own resources and incurring its own liabilities. The contractual arrangement can also specify how the revenues and expenses are to be shared. Another example is where the parties to a joint arrangement might agree to share and operate an asset together. The contractual arrangement establishes the parties' rights to the jointly operated asset and how the output or revenue earned from the asset and the operating costs are shared between the parties. In such a case, each joint operator accounts for its assets and liabilities used for the specific task or its share of the jointly operated asset in its financial statements, as well as its share of the revenues and expenses according to the contractual arrangement.

A joint arrangement in which the assets and liabilities are held in a separate vehicle can be classified either as a joint operation or a joint venture, depending on the rights and obligations of the parties. The legal form of the separate vehicle, the terms of the contractual arrangement and other facts and circumstances must be considered to assess whether the parties either have rights to the assets and obligations for the liabilities of the arrangement (i.e. a joint operation), or they have rights to the net assets of the arrangement (i.e. a joint venture).

12.4 Legal form of the separate vehicle

The legal form of the separate vehicle is considered in the initial assessment of the parties' rights to the assets and obligations for the liabilities held in the separate vehicle. When the joint arrangement is structured through a separate vehicle, the legal form causes the separate vehicle to be considered in its own right, that is the assets and liabilities held in the separate vehicle, are the assets and liabilities of the separate vehicle and not those of the parties. In such a case the assessment of the rights and obligations indicates that the arrangement is a joint venture.

However, the terms agreed by the parties in the contractual arrangement, as well as other facts and circumstances, can override the initial assessment of the rights and obligations as was determined by the legal form.

An arrangement can only be classified as a joint operation when the assessment of the rights and obligations as determined by the legal form, indicate no separation between the parties and the separate vehicle. Thus the assets and liabilities of the separate vehicle are the assets and liabilities of the parties.

12.5 Terms of the contractual arrangement

In many cases the rights and obligations agreed to by the parties in the contractual arrangement are consistent, or do not conflict, with the rights and obligations that determined the legal form of the separate vehicle in which the arrangement has been structured.

In other cases, the parties use the contractual arrangement to reverse or modify the rights and obligations as determined by the legal form of the separate vehicle.

When the contractual arrangement specifies that the parties have rights to the assets and obligations for the liabilities of the arrangement, the arrangement is classified as a joint operation and other facts and circumstances do not need to be considered for classification purposes.

12.6 Other facts and circumstances

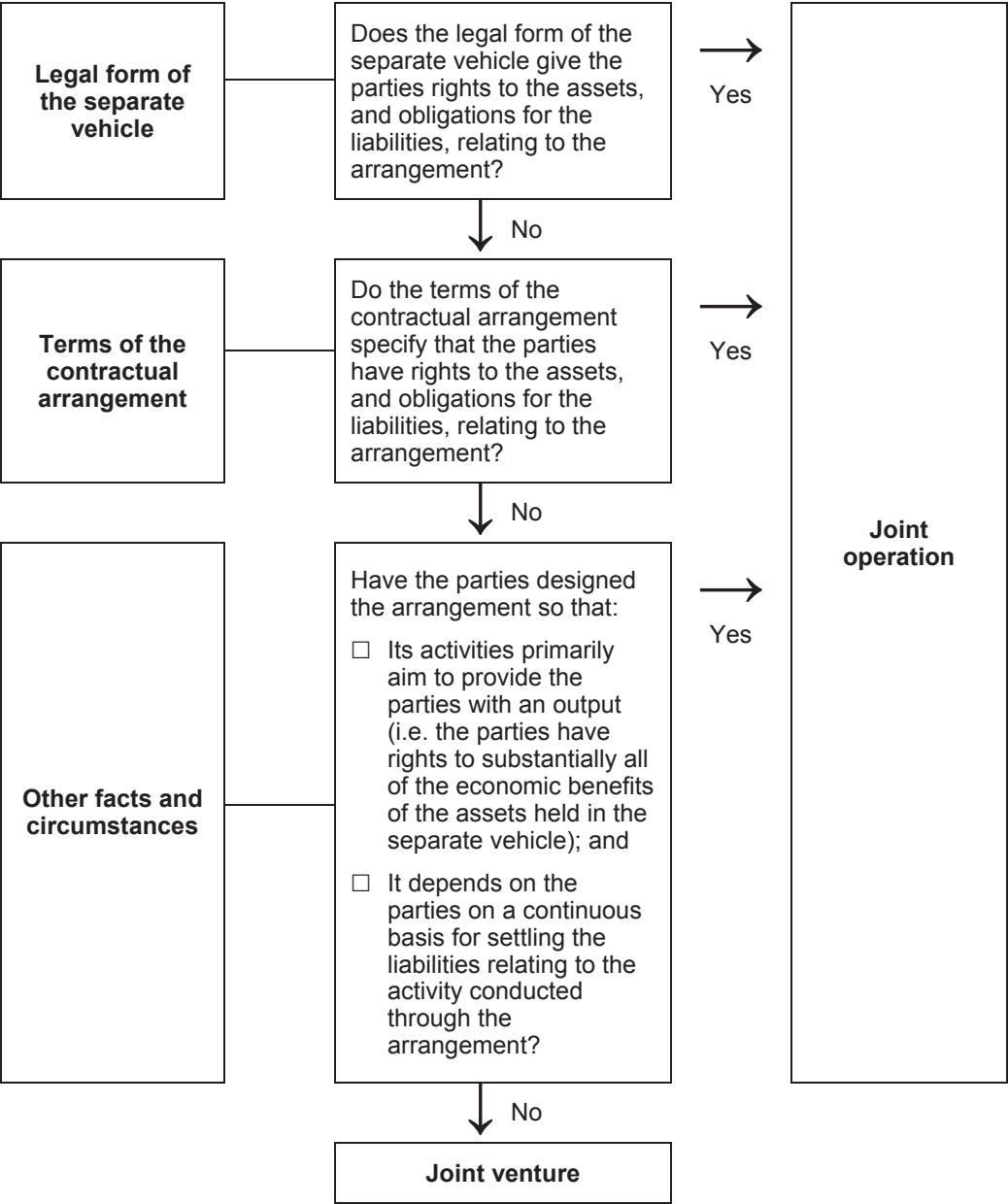
Even though the fact that the legal form and the contractual arrangement may indicate that it is a joint operation, other facts and circumstances may:

- ☐ give the parties rights to substantially all the economic benefits relating to the arrangement; and
- ☐ cause the arrangement to depend on a continuous basis on the parties for settling its liabilities.

In such a case the arrangement is classified as a joint operation.

When the activities of the arrangement are designed to provide output to the parties, it is an indication that the parties have rights to substantially all the economic benefits of the assets of the arrangement. Parties to such arrangements often ensure their access to the output of the arrangement by preventing sales to third parties. The effect of such an arrangement is that the liabilities incurred by the arrangement, is settled only by the cash flow received from the parties through their purchases of the output. When the parties are the only source of cash flow contributing to the continuity of the operations, this indicates that the parties have an obligation for the liabilities of the arrangement and thus such an arrangement is classified as a joint operation.

Classification of a joint arrangement structured through a separate vehicle



Accounting for joint arrangements

12.7 Joint operations

A joint operator includes its interest in a joint operation in its own accounting records and accounts for its interest in its separate financial statements and, if applicable, in its consolidated financial statements according to its share in the joint operation. This includes:

- ☐ its assets, including its share of any assets held jointly;
- ☐ its liabilities, including its share of any liabilities incurred jointly;
- ☐ its share of the revenue from the sale of its share of the output from the joint operation, as well as its share of the revenue from the sale of the output by the joint operation; and
- ☐ its expenses, including its share of any expenses incurred jointly.

A party participating in a joint operation but who does not have joint control, shall account for its interest in the arrangement in the same way as described above, if the party has rights to the assets and obligations for the liabilities of the arrangement.

If such a party does not have rights to the assets and obligations form the liabilities of the arrangement, the interest will be accounted for in accordance with **IFRS 9 Financial Instruments**.

12.8 Joint ventures

A joint venturer shall account for its interest in a joint venture by applying the **equity method** in accordance with **IAS 28 Investments in Associates and Joint Ventures**.

The equity method is an accounting method in terms of which the interest in a joint venture is initially recorded at cost and is subsequently adjusted for the venturer's share of the post-acquisition share of net assets of the joint venture (refer to chapter 11, Investments in associates, for a detailed discussion and explanation of the equity method).

If a party only participates in a joint arrangement and does not have joint control, the interest in the arrangement must be accounted for in accordance with **IFRS 9 Financial Instruments**.

Accounting treatment	Joint arrangement	
	Joint operation	Joint venture
Separate financial statements	Recognise own assets, liabilities and transactions, including its share of those incurred jointly	☐ Cost or ☐ Financial asset (IFRS 9)
Consolidated financial statements	Recognise own assets, liabilities and transactions, including its share of those incurred jointly	Equity method (IAS 28)

**Comment**

The interest in a joint operation is recognised in an entity's **separate financial statements**. Consequently there is no difference in what is recognised in the entity's separate financial statements and the entity's consolidated financial statements.

Disclosure

The disclosure requirements for joint arrangements and associates are set out in **IFRS 12 Disclosure of Interests in Other Entities** (IFRS12.20–23).

An entity must disclose information to enable users of the financial statements to evaluate the nature, extent and financial effects of interests in joint arrangements, including the nature and effects of contractual relationships with other investors with joint control, as well as the nature of and changes in the risks associated with these investments.

An entity must disclose information about significant adjustments and assumptions made in determining:

- ☐ if the entity has joint control of an arrangement or significant influence over another entity; and
- ☐ the type of joint arrangement (i.e. a joint operation or joint venture) if the arrangement was structured through a separate vehicle.

The following disclosure requirements are applicable specifically to joint arrangements that are both joint operations and joint ventures

The following information must be disclosed separately for each joint arrangement (which includes joint operations and joint ventures) that is material to the reporting entity:

- ☐ the name of the joint arrangement;
- ☐ the nature of the entity's relationship with the joint arrangement;
- ☐ the principal place of business (and country of incorporation, if applicable or different); and
- ☐ the proportion of ownership interest or participating share and if different, the proportion of voting rights held.

The following disclosure requirements are applicable specifically to joint ventures

The following information must be disclosed for every joint venture that is **material** to the reporting entity:

- ☐ whether the investment in the joint venture is measured using the equity method or at fair value;
- ☐ summarised financial information of the joint venture (obtained from the financial statements, the total amount and not only the investor's share thereof), including dividends received, non-current and current assets, non-current and current liabilities, revenue, profit or loss from continuing and discontinued operations, other comprehensive income and total comprehensive income;

- ☐ in addition, for every **material joint venture**, cash and cash equivalents, financial current and non-current liabilities (excluding trade and other creditors and provisions), depreciation and amortisation, interest income, interest expense and income tax expense;
- ☐ if the equity method is applied, the fair value of investments in joint ventures for which there are published price quotations;
- ☐ if the equity method is applied, the amounts in the financial statements of the joint venture must be adjusted by fair value adjustments at acquisition and adjustments for differences in accounting policy;
- ☐ if the equity method is applied, a reconciliation must be provided between the summarised financial information and the carrying amount of the interest in the joint venture; and
- ☐ if the interest is measured at fair value or if the joint venture does not prepare IFRS financial statements, the summarised financial information may be prepared on the basis of the joint venture's financial statements.

The following information must be disclosed for joint ventures which are individually **immaterial** to the reporting entity. It must be disclosed in total and separately for all joint ventures which are individually immaterial:

- ☐ the carrying amount in total of all individually immaterial joint ventures that were equity accounted for; and
- ☐ summarised financial information of the joint venture, including profit or loss from continuing and discontinued operations, other comprehensive income and total comprehensive income.

The following must also be disclosed:

- ☐ the nature and extent of any significant restrictions on the joint venture's ability to transfer funds to the entity;
- ☐ if the reporting periods of the entity and the joint venture differ, the reporting period of the joint venture should be mentioned, as well as the reason for the use of different reporting periods;
- ☐ the unrecognised share of losses of a joint venture, both for the current period and cumulatively;
- ☐ commitments that the entity has relating to its joint ventures, which must be separately disclosed from any commitments mentioned above; and
- ☐ any contingent liabilities incurred relating to interests in joint ventures in accordance with **IAS 37 Provisions, Contingent Liabilities and Contingent Assets** which must be separately disclosed.

Examples

Example 12.1	Basic approach – Joint arrangement in a separate entity
---------------------	--

On 2 January 2025, P Ltd acquired 40% of the issued shares of J (Pty) Ltd for R100 000. On this date, the shareholders' equity of J (Pty) Ltd consisted of the following:

Share capital (200 000 shares)	200 000
Retained earnings	50 000
	R250 000

P Ltd exercises joint control over the financial and operating policy decisions of J (Pty) Ltd in terms of a joint arrangement.

Assume a normal tax rate of 27% and that 80% of capital gains are taxable.

The abridged consolidated financial statements of P Ltd and its subsidiaries, as well as the abridged financial statements of J (Pty) Ltd for the year ended 31 December 20.27, are shown below.

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd Group	J (Pty) Ltd
ASSETS		
Property, plant and equipment	750 000	300 000
Investment in J (Pty) Ltd: (80 000 shares at cost)	100 000	—
Inventories	750 000	200 000
Total assets	R1 600 000	R500 000
EQUITY AND LIABILITIES		
Share capital	500 000	200 000
Retained earnings	700 000	200 000
Non-controlling interests	150 000	—
Long-term loans	250 000	100 000
Total equity and liabilities	R1 600 000	R500 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd Group	J (Pty) Ltd
Profit	800 000	600 000
Dividends received from J (Pty) Ltd	120 000	—
Profit before tax	920 000	600 000
Income tax expense	(320 000)	(240 000)
PROFIT FOR THE YEAR	600 000	360 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R600 000	R360 000
Total comprehensive income attributable to:		
Owners of the parent	550 000	360 000
Non-controlling interests	50 000	—
	R600 000	R360 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd Group	J (Pty) Ltd
Balance at 1 January 20.27	400 000	140 000
Changes in equity for 20.27		
Dividends paid	(250 000)	(300 000)
Total comprehensive income for the year:		
Profit for the year	550 000	360 000
Balance at 31 December 20.27	R700 000	R200 000

The joint arrangement will be accounted for as follows:

- (i) Assume that, after considering all the requirements, the joint arrangement is classified as a joint operation. The contractual arrangement specifies that all revenues, expenses, assets and liabilities are allocated according to the respective interests held by the operators.
- (ii) The joint arrangement is classified as a joint venture.

Solution 12.1

(i) Joint operation

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (750 000(P) + 120 000(J))	870 000
Current assets	
Inventories (750 000(P) + 80 000(J))	830 000
Total assets	R1 700 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	500 000
Retained earnings	760 000
	1 260 000
Non-controlling interests	150 000
Total equity	1 410 000
Non-current liabilities	
Long-term loans (250 000(P) + 40 000(J))	290 000
Total equity and liabilities	R1 700 000

P LTD GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS
AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.27

Profit before tax (800 000(P) + 240 000(J))	1 040 000
Income tax expense (320 000(P) + 96 000(J))	(416 000)
PROFIT FOR THE YEAR	624 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R624 000
Total comprehensive income attributable to:	
Owners of the parent	574 000
Non-controlling interests (P)	50 000
	R624 000

P LTD GROUP
EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27

	Retained earnings
Balance at 1 January 20.27 (400 000(P) + 36 000(J))	436 000
Changes in equity for 20.27	
Ordinary dividends (P)	(250 000)
Total comprehensive income for the year:	
Profit for the year	574 000
Balance at 31 December 20.27 (Test: 700 000(P) + 60 000(J))	R760 000

**Comment**

There is no difference in recognising the joint operation in the entity's **separate financial statements** and the entity's **consolidated financial statements**. In the above example the joint operation is shown in the consolidated financial statements as a result of other interests held by the parent (the given information included non-controlling interests).

(ii) Joint venture

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	750 000
Investment in joint venture (100 000 + 60 000)	160 000
	910 000
Current assets	
Inventories (P)	750 000
Total assets	R1 660 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	500 000
Retained earnings	760 000
	1 260 000
Non-controlling interests	150 000
Total equity	1 410 000
Non-current liabilities	
Long-term loans (P)	250 000
Total equity and liabilities	R1 660 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Profit (P)	800 000
Share of profit of joint venture	144 000
Profit before tax	944 000
Income tax expense (P)	(320 000)
PROFIT FOR THE YEAR	624 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R624 000
Total comprehensive income attributable to:	
Owners of the parent	574 000
Non-controlling interests (P)	50 000
	R624 000

P LTD GROUP
EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27

	Retained earnings
Balance at 1 January 20.27 (400 000(P) + 36 000(J))	436 000
Changes in equity for 20.27	
Dividends (P)	(250 000)
Total comprehensive income for the year:	
Profit for the year (550 000 + 24 000)	574 000
Balance at 31 December 20.27 (Test: 700 000(P) + 60 000(J))	R760 000

Calculations**C1 Analysis of owners' equity of J (Pty) Ltd**

	Total	P Ltd 40%	
		At	Since
i At acquisition			
Share capital	200 000	80 000	
Retained earnings	50 000	20 000	
	250 000	100 000	
Investment in J (Pty) Ltd (cost)		(100 000)	
		—	
ii Since acquisition			
• To beginning of current year			
Retained earnings (140 000 – 50 000)	90 000		36 000
• Current year			
Profit for the year	360 000		144 000
Dividends paid	(300 000)		(120 000)
	R400 000		R60 000

C2 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in joint venture (SFP)	60 000	
	Dividends received (P/L) (given)	120 000	
	Retained earnings – Beginning of year (SCE)		
	((140 000 – 50 000) × 40%)		36 000
	Share of profit of joint venture (P/L)		144 000
	Accounting for the joint venture according to the equity method		

Example 12.2	Joint operation not structured in a separate entity
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P Ltd has various farming activities. On 1 January 20.26, P Ltd entered into the following contractual agreement with Z Ltd:

- ☐ Z Ltd will be the only supplier of P Ltd's wheat to customers for the following two years. Z Ltd will market and distribute the wheat. Z Ltd will acquire the necessary equipment to distribute the wheat at its own cost and also make use of its own assets.
- ☐ P Ltd will continue to use its own equipment and existing employees to produce the wheat. These employees and equipment are also used in P Ltd's other farming activities. P Ltd is responsible for all expenses relating to the production of the wheat.
- ☐ Z Ltd incurs all expenses on the retail side. All income from the sale of wheat will be collected by Z Ltd and then shared in the ratio 50:50 between Z Ltd and P Ltd (the profit of the joint operation is also shared in this ratio).
- ☐ Once the wheat inventory has been transferred to Z Ltd, the inventory (and any accounts receivable resulting from the sales) belongs to the operators jointly.

This arrangement is not structured through a separate entity.

The information for the joint operation for the year ended 31 December 20.26 is as follows (no settlement between the joint operators had occurred):

	R
Revenue from sales	2 250 000
Gross production cost	1 275 000
Retail and distribution costs	600 000
Closing inventory (P Ltd)	165 000
Closing inventory (Z Ltd)	172 500
Accounts receivable (31 December 20.26)	322 500

Solution 12.2

Journal entries (P Ltd)

		Dr R	Cr R
J1	Inventory (SFP) Bank (SFP) Cost of production	1 275 000	1 275 000
J2	Joint operation receivable (SFP) (1 275 000 – 165 000) Inventory (SFP) Inventory transferred to joint operation	1 110 000	1 110 000

continued

		Dr R	Cr R
J3	Cost of sales (P/L) $((1\,110\,000 - 172\,500 + 600\,000) \times 50\%)$ Joint operation receivable (SFP) Revenue (P/L) $(2\,250\,000 \times 50\%)$ Share of profit from joint operation	768 750 356 250	1 125 000
J4	Inventory (SFP) (joint operation) $(172\,500 \times 50\%)$ Accounts receivable (SFP) (joint operation) $(322\,500 \times 50\%)$ Joint operation receivable (SFP) Recognise joint operation inventory and receivable	86 250 161 250	247 500

Journal entries (Z Ltd)

		Dr R	Cr R
J1	Joint operation payable (SFP) Bank (SFP) Cost of distribution	600 000	600 000
J2	Bank (SFP) $(2\,250\,000 - 322\,500)$ Joint operation payable (SFP) Revenue received in cash	1 927 500	1 927 500
J3	Cost of sales (P/L) $((1\,110\,000 - 172\,500 + 600\,000) \times 50\%)$ Joint operation payable (SFP) Revenue (P/L) $(2\,250\,000 \times 50\%)$ Share of profit from joint operation	768 750 356 250	1 125 000
J4	Inventory (SFP) (joint operation) $(172\,500 \times 50\%)$ Accounts receivable (SFP) (joint operation) $(322\,500 \times 50\%)$ Joint operation payable (SFP) Recognise joint operation inventory and receivable	86 250 161 250	247 500

13

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Changes in ownership of subsidiaries through buying or selling shares

Acquisitions

Increased interest in existing subsidiary (control not obtained)

- ☐ Transaction with owners
- ☐ Change in the relative interests of the owners recognised directly in **equity**

NCI at
proportionate
share

NCI at
fair value

Investment becomes subsidiary

- ☐ Constitutes a business combination
- ☐ Remeasure previously held equity interest to fair value and recognise remeasurement in profit or loss or other comprehensive income as appropriate (under IFRS 9)
- ☐ Treat cumulative fair value adjustments on investment as if investment was sold

Associate / joint venture becomes subsidiary

- ☐ Equity-accounting for associate / joint venture
- ☐ Constitutes a business combination
- ☐ Remeasure previously held equity interest from carrying amount to fair value and recognise remeasurement in profit or loss (deemed disposal of associate / joint venture)
- ☐ Treat any amounts in OCI of associate as if underlying assets were sold

Other changes of interest

- ☐ Refer to chapter 14

Disposals

Partial disposal of interest in existing subsidiary (control not lost)

- ☐ Transaction with owners
- ☐ Change in the relative interests of the owners recognised directly in **equity**

NCI at
proportionate
share

NCI at
fair value

Disposal of subsidiary

- ☐ Loss of control
- ☐ Derecognise net assets, goodwill and NCI of subsidiary and recognise gain or loss in **profit or loss**
- ☐ Treat any amounts in OCI of subsidiary as if underlying assets were sold
- ☐ Remeasure retained interest to fair value and recognise gain or loss in **profit or loss**
- ☐ Unrealised gains or losses from intragroup transactions would realise

Subsidiary becomes associate / joint venture

- ☐ Loss of control
- ☐ Derecognise net assets, goodwill and NCI of subsidiary and recognise gain or loss in **profit or loss**
- ☐ Treat any amounts in OCI of subsidiary as if underlying assets were sold
- ☐ Remeasure retained equity interest to fair value and recognise gain or loss in **profit or loss**
- ☐ Unrealised gains or losses from intragroup transactions would realise
- ☐ Equity-accounting for associate / joint venture

Subsidiary held for sale

- ☐ Refer to chapter 14

Introduction

13.1 Methods of change in ownership

Changes in ownership in an investee can occur in the following circumstances:

- ☐ piecemeal (/step) acquisition of interests in an investee from other owners;
- ☐ disposal of interests in an investee to other owners;
- ☐ as a result of the issue of additional shares by an investee;
- ☐ as a result of a buy-back of shares by an investee; and
- ☐ as a result of other events such as obtaining or losing control through a contract with other owners.

In previous chapters, it was accepted that:

- ☐ the parent acquired control over the **subsidiary** as a result of a **single purchase** of shares or as a result of the issue of shares to the parent **upon the incorporation of** the subsidiary; and
- ☐ the parent's interest in the **subsidiary** remained **unchanged** throughout the entire period covered by the financial report.

This assumption was adopted in order not to obscure the basic aspects involved in the preparation of consolidated financial statements. It may nevertheless happen that control is obtained not in a single purchase, but by means of **successive share purchases**, or that various **changes** in the nature and extent of ownership of the parent in, or influence of the parent over, the investee could have taken place.

It is important to note that any acquisition of **control** over a **business** would constitute a **business combination** in terms of IFRS 3. Disclosure of the business combination should be made in terms of IFRS 3.59–63 and B64–B67. In this chapter, the business combination will be **achieved in stages** (step-acquisition), and the following information should, in particular, be disclosed (IFRS 3.B64(p)):

- ☐ the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date;
- ☐ the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination; and
- ☐ the line item in the statement of profit or loss and other comprehensive income in which that gain or loss is recognised.



Comments

The acquisition of a subsidiary (i.e. a business combination) during the current year is also known as an **interim acquisition**. Please refer to chapter 8 in Volume 1 for more detail on interim acquisitions, the disclosure requirements for an interim acquisition and illustrations thereof.

The issues arising in the preparation of consolidated financial statements of a group when changes occur in the nature and extent of ownership of the parent in a **subsidiary** are discussed in this chapter. This chapter only deals with:

- ☐ changes in ownership of **subsidiaries**; where
- ☐ the parent **buys** or **sells** shares of the subsidiary.

Changes in the ownership of associates and joint ventures through buying or selling shares of the associate and joint ventures were addressed in the chapter on investments in associates and joint ventures (see chapter 11). The next chapter of this work deals with **other changes** (e.g. rights issues, buyback, etc.) in the ownership of **investees** (see chapter 14).

Acquisition of interests in subsidiaries

13.2 Methods of step-acquisition

There are various ways in which interests can be acquired on a piecemeal basis:

- ☐ acquisition of an additional interest in an **existing** subsidiary/associate/joint venture (i.e. there is no change in status of the investee); and
- ☐ acquisition of an additional interest in an entity, with the result that the entity **becomes** a subsidiary/associate/joint venture (i.e. a change in status).

It was mentioned that this chapter only deals with subsidiaries and that changes in associates and joint ventures through share purchases are addressed in the chapter on associates and joint ventures (chapter 11).

13.3 Acquisition of an additional interest in an existing subsidiary

- 1 IFRS 10.23 states that **changes in a parent's ownership interest** in a subsidiary **that do not result in a loss of control** are accounted for as **equity** transactions (i.e. transactions with owners in their capacity as owners). It should be borne in mind that the non-controlling interests are also classified as equity (IFRS 10.22). Furthermore, the **consolidated carrying amounts** of the parent's and non-controlling interests must be adjusted to reflect the change in their relative interests in the subsidiary. This change shall be recognised **directly in equity** and is attributable to the owners of the parent. This means that no gain or loss should be recognised in the consolidated profit or loss.



Comments

It is important to note that the parent's and non-controlling interests in the **consolidated carrying amount** of the subsidiary are re-calculated, and that there is no remeasurement to fair value (as with a business combination – refer to chapter 9). The consolidated carrying amount relating to the subsidiary is calculated after any adjustments with the business combination and any normal consolidation adjustments were made. Furthermore, the adjustment for the change in the ownership interest is made directly within **equity**, and no goodwill or bargain gain is recognised.

The acquisition by the parent of **additional shares** in an existing subsidiary that it already controls, is **not a business combination** (obtaining control). This transaction does **not** result in **additional goodwill** being recognised and does not affect the measurement of the subsidiary's assets and liabilities, as would be the case for a business combination. This means that no change in the carrying amount of the subsidiary's assets (including goodwill) or liabilities is recognised. The transaction only changes the parent's and non-controlling interests' **relative interests** in the consolidated carrying amount of the subsidiary.

- 2 IFRS 10.B96 states that the amount to be recognised in equity would be the difference between the amount by which the **non-controlling interests** are adjusted and the fair value of the consideration paid or received. This adjustment in the amount of the non-controlling interests will be affected by the initial measurement of the non-controlling interests at the date of the business combination (at its proportionate share of the acquiree's identifiable net assets or at fair value), which is illustrated in the examples below.

There may arguably be various approaches to calculate the adjustment to the non-controlling interests. It is important to note the IFRIC has considered the issue of the reallocation of the equity represented by goodwill between the non-controlling and controlling interests after a change in a parent's ownership interest where control is not lost. The IFRIC has recommended that the IASB should address this issue (and other related issues) as part of their IFRS 3 post-implementation review. Refer to the IFRIC Update September 2010 and the IASB Update May 2011 for more detail. During the IASB's post-implementation review of IFRS 3, they regarded the measurement of the non-controlling interests as a "low" significance for future steps to be taken. Until a final conclusion has been reached, this work follows the approach that the **equity represented by goodwill is only re-attributed between the parent and the non-controlling interests if any goodwill was initially recognised in respect of the non-controlling interests** (i.e. NCI measured at fair value) (also see comment (b) to the analysis in example 13.1b). Under this approach, the subsidiary basically consists of two separate asset pools: one asset pool in respect of all the **other net assets** (excluding goodwill); and **goodwill** (which may be recognised only in respect of the parent's interest or for both the parent's and the non-controlling interests').

- 3 **Disclosure** of the change in a parent's ownership interest in a subsidiary that did not result in a loss of control should be made in terms of **IFRS 12 Disclosure of Interests in Other Entities**. The parent shall disclose information that enables users of the consolidated financial statements to evaluate the consequences of such changes (IFRS 12.10(b)(iii)). In meeting this requirement, the parent shall present a schedule that shows the **effect on the equity** attributable to the owners of the parent of any changes in its ownership interest in a subsidiary that did not result in a loss of control (IFRS 12.18).

Example 13.1a

Acquisition of a further interest in an existing subsidiary where the subsidiary remains a subsidiary (there is no change in status) (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)

The following are the draft condensed financial statements of P Ltd and subsidiary S Ltd at 30 June 20.29:

STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 20.19		
	P Ltd	S Ltd
ASSETS		
Investment in S Ltd at cost:		
90 000 shares purchased on 1/7/20.27	97 000	—
30 000 shares purchased on 31/12/20.28	40 000	—
Inventory	106 000	182 500
Total assets	R243 000	R182 500
EQUITY AND LIABILITIES		
Share capital (200 000/150 000 shares)	200 000	150 000
Retained earnings	43 000	32 500
Total equity and liabilities	R243 000	R182 500

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.29		
	P Ltd	S Ltd
Revenue	200 000	100 000
Cost of sales	(157 000)	(58 000)
Gross profit	43 000	42 000
Dividend received	6 000	—
Profit before tax	49 000	42 000
Income tax expense	(14 000)	(11 500)
PROFIT FOR THE YEAR	35 000	30 500
Other comprehensive income	—	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R35 000	R30 500

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.29		
	Retained earnings	
	P Ltd	S Ltd
Balance at 1 July 20.28	18 000	12 000
Changes in equity for 20.29		
Total comprehensive income for the year:		
Profit for the year	35 000	30 500
Other comprehensive income	—	—
Dividends: 30/9/20.28	(10 000)	(10 000)
Balance at 30 June 20.29	R43 000	R32 500

Additional information

- 1 S Ltd became a subsidiary of P Ltd on 1 July 20.27, on which date the credit balance on its retained earnings amounted to R9 000. On this date, P Ltd acquired 90 000 shares in S Ltd at a cost of R97 000.
- 2 P Ltd elected to measure the non-controlling interests at the non-controlling interests' proportionate share of the acquiree's identifiable net assets at the acquisition date.
- 3 On the date of the business combination, the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3.
- 4 P Ltd classified the investment in S Ltd at cost in its separate financial statements.
- 5 On 31/12/20.28, P Ltd acquired another 30 000 shares in S Ltd from the other shareholders at a cost of R40 000.
- 6 The profit of S Ltd was earned evenly during the current year ended 30 June 20.29.
- 7 The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof.

	Comments a The date of the business combination is 1 July 20.27. At that date, the assets and liabilities of S Ltd were regarded to be fairly measured in terms of IFRS 3. Therefore, no remeasurements of any item were needed. However, if the assets and liabilities were not fairly valued, remeasurements may have been needed, as explained in chapter 9. b The acquisition of the 30 000 shares on 31/12/20.28 does not constitute a business combination as P Ltd already had control over S Ltd. The transaction was between equity participants, and the effect of the transaction should be recognised within equity in the consolidated financial statements.
--	---

Solution 13.1a

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.29	
ASSETS	
Non-current assets	
Goodwill	1 600
Current assets	
Inventory (106 000(P) + 182 500(S))	288 500
Total assets	R290 100
EQUITY AND LIABILITIES	
Share capital	200 000
Retained earnings	60 150
Other components of equity (changes in ownership)	(6 550)
	253 600
Non-controlling interests	36 500
Total equity	290 100
Total equity and liabilities	R290 100

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.29	
Revenue (200 000(P) + 100 000(S))	300 000
Cost of sales (157 000(P) + 58 000(S))	(215 000)
Gross profit (43 000(P) + 42 000(S))	85 000
Income tax expense (14 000(P) + 11 500(S))	(25 500)
PROFIT FOR THE YEAR	59 500
Other comprehensive income for the year	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R59 500
Profit attributable to:	
Owners of the parent(#)	50 350
Non-controlling interests (6 100 + 3 050)(#)	9 150
	R59 500
Total comprehensive income attributable to:	
Owners of the parent(#)	50 350
Non-controlling interests (6 100 + 3 050)(#)	9 150
	R59 500

(#) The same as profit for the year, as there is no other comprehensive income in the example.

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.29						
	Share capital	Retained earnings	Changes in ownership	Total	Non-controlling interests	Total equity
Balance at 1 July 20.28	200 000	* 19 800	–	219 800	! 64 800	284 600
Changes in equity for 20.29						
Total comprehensive income for the year:						
Profit for the year	–	50 350	–	50 350	9 150	59 500
Dividends	–	(10 000)	–	(10 000)	(4 000)	(14 000)
Purchase of interest	–	–	(6 550)	(6 550)	(33 450)	(40 000)
Balance at 30 June 20.29	R200 000	R60 150	(R6 550)	R253 600	R36 500	R290 100

* 18 000(P) + 1 800(S) = 19 800

! 63 600 + 1 200 = 64 800

P LTD GROUP NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	
Changes in ownership in subsidiary:	
During the current year, P Ltd acquired an additional 20% interest in S Ltd, an existing subsidiary. This resulted in an amount of R6 550 being recognised in equity as presented in the consolidated statement of changes in equity. Details of the transaction between the equity participants are as follows:	
Fair value of the consideration paid	40 000
Decrease in the non-controlling interests	(33 450)
Adjustment to equity attributable to owners of the parent	R6 550

	Comments
IFRS 12.18 requires that an entity shall present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control. Other disclosures relating to the group and the subsidiary are also required in terms of IFRS 12, but are not illustrated in chapters 13 and 14 in detail.	

Calculations

The basic consolidation procedures comprise:

- ☐ elimination of common items;
- ☐ elimination of intragroup items; and
- ☐ the consolidation of the remaining items.

In this chapter, the shorter method is used to perform the basic consolidation procedures (i.e. no worksheet is drawn up). The pro forma consolidation journal entries are also shown to provide a complete picture.

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 60%–80%		NCI
		At	Since	
i At acquisition (1/7/20.27)				
Share capital	150 000	90 000		60 000
Retained earnings	9 000	5 400		3 600
	159 000	95 400		63 600
Equity represented by goodwill — Parent	1 600	1 600		—
Consideration and NCI	160 600	97 000		63 600
ii Since acquisition				
• To beginning of current year: Retained earnings (12 000 – 9 000)	3 000		1 800	1 200
• Current year: Profit: 1/7/20.28–31/12/20.28 (30 500 × 6/12)	15 250		9 150	6 100
Dividend: 30/9/20.28	(10 000)		(6 000)	(4 000)
	168 850		4 950	66 900
Further acquisition (66 900 (NCI) × 20/40 = 33 450)		33 450		(33 450)
Changes in ownership (equity) (per IFRS 10.23)		6 550		
Consideration and NCI		40 000		33 450
Profit: 1/1/20.29–30/6/20.29 (30 500 × 6/12)	15 250		12 200	3 050
	R184 100		R17 150	R36 500 (*)

(*) Note that, due to the inclusion of the **goodwill** of R1 600 (relating to the parent only) in the total equity column, this amount will no longer equate to exactly 20% of the total equity column.



Comments

- a The analysis represents a chronological exposition of the events that affect the owners' equity in the subsidiary.
- b The profit of the current period is allocated to two periods, namely the periods before and after the change in owners' equity. Special attention must be paid to the treatment of the subsidiary's dividend declared/paid, which relates to a specific date and must therefore be allocated to the correct period – in this example, to the period **before** the acquisition of additional shares by the parent.
- c The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the NCI)**:

Fair value of the consideration received by NCI	40 000
Amount by which the non-controlling interests are adjusted (reserves acquired by parent from NCI) $(66\,900 \times 20/40 = 33\,450)$	(33 450)
NCI after transaction $((168\,850 - 1\,600\text{GW}) \times 20\%)$	33 450
NCI before transaction $((168\,850 - 1\,600\text{GW}) \times 40\%)$	(66 900)
Amount to be recognised directly in equity	<u>R6 550</u>

The approach in terms of IFRS 10.B96 that the difference between the change in the non-controlling interests and the amount paid or received is to be recognised in equity is also clear from journal 5 below.

It is important to understand the rationale of the calculation of the change in ownership. The non-controlling shareholders sold 50% of their interest in the subsidiary to the parent. The carrying amount of the NCI is therefore reduced by 50%, being R33 450. The parent paid R40 000 for this equity, and, as such, the difference of R6 550 is recognised within equity as a transaction between the equity participants.

- d The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the parent)**:

Fair value of the consideration paid by the parent	(40 000)
Increase in parent's interest/amount by which the non-controlling interests are adjusted (reserves acquired from NCI)	33 450
Parent's interest after transaction $((168\,850 - 1\,600\text{GW}) \times 80\%) + 1\,600\text{GW}$	135 400
Parent's interest before transaction $((168\,850 - 1\,600\text{GW}) \times 60\%) + 1\,600\text{GW}$	(101 950)
Amount to be recognised directly in equity	<u>(R6 550)</u>

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	97 000
Amount of non-controlling interests: IFRS 3.32(a)(ii) $(159\,000 \times 40\%)$	63 600
	<u>160 600</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(159 000)
Goodwill (parent)	<u>R1 600</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Share capital (SCE) Retained earnings (SCE) Investment in S Ltd (SFP) Non-controlling interests (SCE) Goodwill (SFP) (parent only) Main elimination journal entry at acquisition date	150 000 9 000 1 600	 97 000 63 600
J2	Retained earnings (SCE) Non-controlling interests (SCE) Non-controlling interests' portion of retained earnings since acquisition to beginning of current year	1 200	1 200
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Non-controlling interest's portion of current year's profit (1/7/20.28–31/12/20.28, i.e. before additional acquisition)	6 100	6 100
J4	Dividend received (P/L) Non-controlling interests (SCE) Dividend paid (SCE) Elimination of intragroup dividend	6 000 4 000	10 000
J5	Non-controlling interests (SCE) Changes in ownership (equity) (SCE) (IFRS 10.23) Investment in S Ltd (SFP) Acquisition of a further 20% interest in S Ltd eliminated	33 450 6 550	40 000
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Non-controlling interests' portion of current year's profit (1/1/20.29–30/6/20.29, i.e. after additional acquisition)	3 050	3 050

C4 Test of consolidated equity

P Ltd (200 000 + 43 000)	243 000
S Ltd (Retained earnings per analysis)	17 150
	<u>R260 150</u>
Consolidation adjustments (refer to pro forma consolidation journal entries)	
☐ Recognised change in ownership (in terms of IFRS 10.23)	(6 550)
☐ Recognised non-controlling interests	36 500
Consolidated equity	<u>R290 100</u>

C5 Detailed calculation of allocation of equity

	Total	Attributable to parent	Attributable to NCI
Equity of subsidiary before change represented by:	168 850	101 950	66 900
Other net assets	167 250	100 350	66 900
Goodwill	1 600	1 600	–
Change in ownership represented by:		33 450	(33 450)
Other net assets reallocated		33 450	(33 450)
Goodwill relinquished		N/A	N/A
Equity of subsidiary after change represented by:	168 850	135 400	33 450
Other net assets	167 250	133 800	33 450
Goodwill	1 600	1 600	–



Comments

- No fair value adjustment was made to the non-controlling interests at the acquisition date as P Ltd **elected** to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. Refer to IFRS 3.19.
- This example is not a business combination achieved in stages (i.e. a step-acquisition) as defined in IFRS 3.41 and .42, as P Ltd obtained control at the date of the first share purchase (i.e. the acquisition of the 60% interest). Since S Ltd immediately became a subsidiary, no remeasurement of the previously held equity interest in S Ltd is required as per IFRS 3.42.
- IFRS 10.23 requires that changes in a parent's owners' equity in a subsidiary **that do not result in a loss of control** (which is the case in this example) are accounted for as equity transactions (i.e. transactions with owners **in their capacity as owners**). In this chapter, these equity transactions will be referred to as "changes in ownership" as can be seen in the journal entries and the statement of changes in equity. IFRS 10 is not specific about the exact equity category to be used for this transaction. The authors are of the opinion that a **separate** equity category should be used, because the transaction is regarded as equity by IFRS 10 and specifically transactions with owners **in their capacity as owners**. Some are of the opinion that the transaction should be accounted for within retained earnings, which is also an acceptable alternative.
- In volume 1 of this work (paragraph 3.3), it was indicated that the investment in the subsidiary (in the parent's records) represents a claim against the net assets of the subsidiary as represented by its equity. As a result, it should be eliminated in the consolidated financial statements (i.e. an elimination of common items in terms of IFRS 10.B86(b)). As a result of the journal entries above, the investment is indeed eliminated: Investment of R137 000 (given) – R97 000 (J1) – R40 000 (J5) = Rnil.
- The two separate asset pools and the allocation of these asset pools between the parent and the non-controlling interests are clearly evident from Calculation 5 above.

The following example is used to contrast the **measurement of the non-controlling interests at fair value** at the acquisition date, to the measurement thereof at their proportionate share of the acquiree's identifiable net assets (as in the example above).

Example 13.1b	Acquisition of a further interest in an existing subsidiary where the subsidiary remains a subsidiary (there is no change in status) (NCI is measured at fair value at the date of acquisition)
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Assume the same information as in example 13.1a, except that P Ltd elected to measure non-controlling interests at fair value at the date of acquisition. The fair value of the non-controlling interests was R64 200 at the acquisition date (when P Ltd obtained control over S Ltd).

	Comments Measuring the non-controlling interests at fair value at the acquisition date implies that the non-controlling interests will now also share in the equity represented by goodwill . This can clearly be seen in the analysis of the owners' equity below.
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Solution 13.1b

The consolidated statement of profit or loss and other comprehensive income is the same as in part (a) of this example. The rest of the consolidated financial statements are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.29	
ASSETS	
Non-current assets	
Goodwill (parent and NCI)	2 200
Current assets	
Inventory (106 000(P) + 182 500(S))	288 500
Total assets	R290 700
EQUITY AND LIABILITIES	
Share capital	200 000
Retained earnings	60 150
Other components of equity (changes in ownership)	(6 250)
	253 900
Non-controlling interests	36 800
Total equity	290 700
Total equity and liabilities	R290 700

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.29						
	Share capital	Retained earnings	Changes in ownership	Total	Non-controlling interests	Total equity
Balance at 1 July 20.28	200 000	* 19 800	—	219 800	! 65 400	285 200
Changes in equity for 20.29						
Total comprehensive income for the year:						
Profit for the year	—	50 350	—	50 350	9 150	59 500
Dividends	—	(10 000)	—	(10 000)	(4 000)	(14 000)
Purchase of interest	—	—	(6 250)	(6 250)	(33 750)	(40 000)
Balance at 30 June 20.29	R200 000	R60 150	(R6 250)	R253 900	R36 800	R290 700

* 18 000(P) + 1 800(S) = 19 800

! 63 600 + 600 (represented by goodwill) + 1 200 (interest in RE) = 65 400

P LTD GROUP NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	
Changes in ownership in subsidiary: During the current year, P Ltd acquired an additional 20% interest in S Ltd, an existing subsidiary. This resulted in an amount of R6 250 being recognised in equity as presented in the consolidated statement of changes in equity. Details of the transaction between the equity participants are as follows: Fair value of the consideration paid Decrease in the non-controlling interests Adjustment to equity attributable to owners of the parent	40 000 (33 750) R6 250

Calculations**C1 Analysis of the owners' equity of S Ltd**

	Total	P Ltd 60%–80%		NCI
		At	Since	
i At acquisition (1/7/20.27)				
Share capital	150 000	90 000		60 000
Retained earnings	9 000	5 400		3 600
	159 000	95 400		63 600
Equity represented by goodwill – Parent and NCI (comment (a))	2 200	1 600		600
Consideration and NCI	161 200	97 000		64 200
ii Since acquisition				
• To beginning of current year: Retained earnings (12 000 – 9 000)	3 000		1 800	1 200
• Current year: Profit: 1/7/20.28–31/12/20.28 Dividend: 30/9/20.28	15 250 (10 000)		9 150 (6 000)	6 100 (4 000)
	169 450		4 950	67 500
Further acquisition (67 500 (NCI) × 20/40 = 33 750)		33 750		(33 750)
Changes in ownership (equity) (per IFRS 10.23)		6 250		
Consideration and NCI		40 000		33 750
Profit: 1/1/20.29–30/6/20.29	15 250		12 200	3 050
	R184 700		R17 150	R36 800 (*)

(*) This amount will not be 20% of the total equity of S Ltd as the goodwill (at the acquisition date) that was included in the equity at acquisition date is not in the same proportion as the owners' equity at the acquisition date.



Comments

- a Since NCI is now measured at fair value, the goodwill arising at acquisition date is treated as an asset of the subsidiary, i.e. equity also increases by that same amount (R2 200) at acquisition in order for the accounting equation to stay in balance, as follows:

EQUITY = ASSETS LESS LIABILITIES
+ 2 200 = +2 200 (goodwill)

This amount is seen in the total equity column. The net equity, therefore, represents the goodwill contributed of R2 200.

- b The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (**from the perspective of the NCI**):

Fair value of the consideration received by NCI	40 000
Amount by which the non-controlling interests are adjusted (reserves acquired by parent from NCI and goodwill re-attributed) (67 500 × 20/40 = 33 750)	(33 750)
NCI after transaction ((169 450 – 2 200GW) × 20% + (600GW × 20/40))	33 750
NCI before transaction ((169 450 – 2 200GW) × 40% + (600GW × 40/40))	(67 500)
Amount recognised directly in equity	<u>R6 250</u>

Through the parent's acquisition of another 20% interest in the subsidiary, 20% of the net asset value (excluding goodwill) ((169 450 – 2 200) × 20% = 33 450) was transferred from the non-controlling interests to the parent's interest. Furthermore, the non-controlling owners relinquished some of the goodwill (600 × 20/40 = 300) that was attributable to them to the parent. This resulted in a decrease in the non-controlling interests of R33 750 (33 450 + 300).

Take note that the amount for **goodwill** in the consolidated financial statements is not adjusted. It is the **equity**, represented by the goodwill, that is re-attributed between the equity participants (parent and NCI).

As was explained in paragraph 13.3 above, this work follows the approach that the non-controlling owners relinquished some of the goodwill that was attributable to them to the parent, only where goodwill was recognised for the non-controlling interests at acquisition (i.e. the non-controlling interests were measured at fair value).

- c The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (**from the perspective of the parent**):

Fair value of the consideration paid by the parent	(40 000)
Increase in parent's interest / amount by which the non-controlling interests are adjusted (reserves acquired from NCI)	33 750
Parent's interest after transaction ((169 450 – 2 200GW) × 80%) + 1 600 own GW + 300GW from NCI)	135 700
Parent's interest before transaction ((169 450 – 2 200GW) × 60%) + 1 600 own GW)	(101 950)
Amount to be recognised directly in equity	<u>(R6 250)</u>

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	97 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	64 200
	<u>161 200</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(159 000)
Goodwill (parent and NCI)	<u>R2 200</u>

C3 Pro forma consolidation journal entries

The pro forma consolidation journal entries are the same as in example 13.1a, except for those indicated below.

		Dr R	Cr R
J1	Share capital (SCE)	150 000	
	Retained earnings (SCE)	9 000	
	Investment in S Ltd (SFP)		97 000
	Non-controlling interests (SCE)		64 200
	Goodwill (parent and NCI) (SFP)	2 200	
	Main elimination journal entry at acquisition date		
J5	Non-controlling interests (SCE)	33 750	
	Changes in ownership (equity) (SCE) (IFRS 10.23)	6 250	
	Investment in S Ltd (SFP)		40 000
	Acquisition of a further 20% interest in S Ltd eliminated		

C4 Test of consolidated equity

P Ltd (200 000 + 43 000)	243 000
S Ltd (RE per analysis)	17 150
	<u>R260 150</u>
Consolidation adjustments (refer to pro forma consolidation journal entries)	
☐ Recognised change in ownership (in terms of IFRS 10.23)	(6 250)
☐ Recognised non-controlling interests	36 800
Consolidated equity	<u>R290 700</u>

C5 Detailed calculation of allocation of equity

	Total	Attributable to parent	Attributable to NCI
Equity of subsidiary before change represented by:	169 450	101 950	67 500
Other net assets	167 250	100 350	66 900
Goodwill	2 200	1 600	600
Change in ownership represented by:		33 750	(33 750)
Other net assets reallocated		33 450	(33 450)
Goodwill relinquished		300	(300)
Equity of subsidiary after change represented by:	169 450	135 700	33 750
Other net assets	167 250	133 800	33 450
Goodwill	2 200	1 900	300

**Comments**

- a In this example (compared to example 13.1a), the non-controlling interests at the acquisition date are measured at the acquisition-date fair value, as P Ltd **elected** to measure the non-controlling interests at fair value. Refer to IFRS 3.19.
- b The goodwill recognised from the perspective of the non-controlling interests, as a result of the measurement of the non-controlling interests at fair value, should be taken into account in adjusting the carrying amount of the non-controlling interests to reflect the change in their relative interest in the subsidiary.

- 4 If an increase in the parent's interest has taken place, the analysis of the subsidiary's owners' equity also separately reflects this **increase in interest in every consolidation thereafter**. This is done to ensure that changes in ownership (which are regarded as transactions with owners) are determined separately, and transfers to and from the non-controlling interests are correctly taken into account at the relevant dates. With reference to example 13.1a, the appropriate sections of S Ltd's analysis of owners' equity with a view to the consolidation on **30 June 20.20** (end of the next reporting period) will be as follows:

Analysis of the owners' equity of S Ltd

	Total	P Ltd 60%–80%		NCI
		At	Since	
i At acquisition (1/7/20.27)				
Share capital	150 000	90 000		60 000
Retained earnings	9 000	5 400		3 600
	159 000	95 400		63 600
Equity represented by goodwill – Parent	1 600	1 600		–
Consideration and NCI	160 600	97 000		63 600
ii Since acquisition				
• To beginning of current year: The period: 1/7/20.27–31/12/20.28				
Retained earnings (aggregated)	8 250		4 950	3 300
	168 850			66 900 (33 450)
Purchase of shares (20%)		33 450		
Changes in ownership (equity)		6 550		
Consideration and NCI		40 000		33 450
The period: 1/1/20.29–30/6/20.29				
Retained earnings	15 250		12 200	3 050
• Current year: detail for that year				

- 5 A change in the degree of control usually means that the profit and items of other comprehensive income of the subsidiary involved must, for the current period, be allocated between two periods, i.e. the periods **before** and **since** the change in the degree of control. As indicated earlier, the retained earnings of a subsidiary are dealt with in the **analysis of owners' equity** by accounting for the constituent elements thereof, namely profit and dividends.

☐ **Profit**

The allocation is generally done evenly on the assumption that profit is earned evenly during the period, except where the operations of the subsidiary clearly reflect fluctuations or unique items. Certain items arising from the consolidation process must also first be accounted for before such allocation can be made, for example, the allocation of the preference dividend of the subsidiary or the increased depreciation of the subsidiary resulting from a pro forma remeasurement of a depreciable asset of the subsidiary at the acquisition date.

Unrealised profit resulting from regular sales of inventories by the subsidiary to the parent should, in general, be treated as follows:

- Unrealised profit at the beginning of the period realises in the period **before** the change in the degree of control.
- Unrealised profit at the date of the change in the degree of control realises in the period **since** (after) the change in interest.

☐ **Dividends**

Dividends are allocated to the relevant period (before or after the change in interest) based on the date on which the dividend was declared by the subsidiary (and no longer at the discretion of the entity – refer to IFRIC 17).

☐ **Items of other comprehensive income**

Items of other comprehensive income are usually the result of fair value movements or the remeasurement of assets or liabilities. These items are allocated to the relevant period (before or after the change in interest) based on when the fair value movements occurred or when the assets or liabilities were remeasured.

13.4 Acquisition of an additional interest whereby the investee (investment) becomes a subsidiary

1 In the previous chapters, it was repeatedly emphasised that:

- ☐ the **acquisition date** is an important point in time; and
- ☐ the periods before and after the acquisition date are important **time phases** in the preparation of consolidated financial statements.

IFRS 3 Business Combinations defines the acquisition date as the date on which the acquirer effectively **obtains control** over the acquiree. An investor may have had a simple investment in an entity (say 15%, without significant influence or control), and later obtained an **additional interest** in the entity, resulting in obtaining control. In accounting for such a business combination, the investor would effectively derecognise the previously held **investment** at its fair value, and then account for the **business combination** in terms of IFRS 3 (refer to chapters 2 and 9 for more detail). The accounting for a business combination achieved in stages is prescribed in IFRS 3.41 and .42, and paragraphs BC384–BC389 in the basis for conclusions supporting IFRS 3.

2 IFRS 3 establishes the acquisition date as the single measurement date for all assets acquired, liabilities assumed, and any non-controlling interests in the acquiree (refer to chapters 2 and 9 for detail). The obtaining of control, therefore, triggers the remeasurement of all the identifiable net assets of the subsidiary and the recognition of goodwill (if any). In a business combination achieved in stages, the acquirer furthermore **remeasures** its previously held equity interest in the acquiree at its acquisition-date **fair value**, and recognises the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate (refer to IFRS 3.42).

In prior reporting periods, the acquirer (in its **separate** financial statements) may have recognised changes in the fair value of its equity interest in the acquiree in **other comprehensive income** (e.g. because the parent elected to do so in accordance with **IFRS 9 Financial Instruments**). If so, the amount that was previously recognised in other comprehensive income shall be recognised **as if** (i.e. as part of the pro forma journal entries only) the acquirer had **disposed** directly of the previously held equity interest. This may require the acquirer (in the consolidated financial statements) to transfer the amount in the mark-to-market reserve to retained earnings (IFRS 9.B5.7.1) on the date that **control** is obtained over the acquiree. This would, for example, occur when a simple investment that was previously measured at “fair value through other comprehensive income” now

becomes a subsidiary over which control is exercised in the current year. Thus, all the fair value adjustments on the equity investment that were previously recognised in a mark-to-market reserve (i.e. other comprehensive income) before control was obtained, will be transferred within equity (in the consolidated financial statements) when control over the subsidiary is obtained.

The IASB motivated the approach above by concluding that a change from holding a non-controlling investment in an entity to obtaining control of that entity, is a **significant change** in the nature of and economic circumstances surrounding that investment. That change warrants a change in the classification and measurement of that investment. Once it obtains control, the acquirer is no longer the owner of a non-controlling investment (asset) in the acquiree. The acquirer, therefore, ceases its accounting for an investment (asset) and begins reporting in its consolidated financial statements the underlying assets, liabilities and results of the **operations** of the acquiree. In a business combination achieved in stages, the acquirer basically derecognises its investment asset in an entity in its consolidated financial statements when it achieves control (refer to IFRS 3.BC384–389). The above approach is, therefore, similar to **disposing of an equity investment** and then buying a controlling interest in a subsidiary through a business combination.

The fair value of the previously held investment, plus the consideration for the additional purchase (measured under IFRS 3) leading to obtaining control, would represent the “cost” of the investment in the subsidiary (as in the parent’s separate financial statements when applying IAS 27) (which may be referred to the “fair value as deemed cost approach” – refer to IFRIC Update of January 2019).

- 3 Full **disclosure** of the business combination is made in terms of IFRS 3. For a business combination achieved in stages, the following information should, in particular, be disclosed:
 - ☐ the acquisition-date fair value of the equity interest previously held;
 - ☐ the amount of any gain or loss recognised as a result of remeasuring the above-mentioned interest to fair value; and
 - ☐ the line item in which the gain or loss was recognised.



Comments

A business combination during the current year is also known as an **interim acquisition**. Please refer to chapter 8 in Volume 1 for more detail on interim acquisitions, the disclosure requirements for an interim acquisition and illustrations thereof.

- 4 With regards to a simple investment classified as subsequently measured at fair value through other comprehensive income (under IFRS 9) that becomes a subsidiary during the current period, the following consolidation procedures will be relevant:
 - ☐ transfer any mark-to-market reserve relating to the fair value gains on the previously held equity interest in the acquiree (being subsequently measured at fair value through other comprehensive income, if so elected under IFRS 9) to retained earnings (as if the simple investment was disposed of and a controlling interest purchased (IFRS 3.42));
 - ☐ **remeasurement** of identifiable net assets in terms of IFRS 3 (see chapters 2 and 9), where applicable;

- ☐ **elimination of common items** at the acquisition date and the recognition and measurement of any goodwill or bargain gain and non-controlling interests (it should be noted that the retained earnings or reserves that will be eliminated at the acquisition date would comprise of the opening balances at the beginning of the year, the net profit for the period of the current year (various line items in the statement of profit or loss), and the items in other comprehensive income, before the acquisition date – similar to the interim acquisition of a subsidiary that was addressed in chapter 8); and
- ☐ applying basic **consolidation principles** after the acquisition date.

Example 13.2	Acquisition of a further interest where the investment becomes a subsidiary (NCI is measured at fair value at the date of acquisition)
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The following are the draft condensed financial statements of P Ltd and subsidiary S Ltd at 31 December 20.29:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29		
	P Ltd	S Ltd
ASSETS		
Property, plant and equipment	400 000	505 500
Investment in S Ltd (fair value of the previously held interest of R54 000 plus additional consideration of R216 000)	270 000	–
Total assets	R670 000	R505 500
EQUITY AND LIABILITIES		
Share capital (150 000/100 000 shares)	150 000	100 000
Mark-to-market reserve	10 976	–
Retained earnings	506 000	405 500
Deferred tax	3 024	–
Total equity and liabilities	R670 000	R505 500

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29		
	P Ltd	S Ltd
Revenue	700 000	600 000
Cost of sales	(280 000)	(240 000)
Gross profit	420 000	360 000
Other expenses	–	(90 000)
Profit before tax	420 000	270 000
Income tax expense	(120 000)	(81 000)
PROFIT FOR THE YEAR	300 000	189 000
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Mark-to-market reserve (fair value adjustment to investment)	4 000	–
Income tax relating to items that will not be reclassified	(864)	–
Other comprehensive income for the year, net of tax	3 136	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R303 136	R189 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29			
	Mark-to-market reserve P Ltd	Retained earnings	
		P Ltd	S Ltd
Balance at 1 January 20.29	7 840	206 000	216 500
Changes in equity for 20.29			
Total comprehensive income for the year:			
Profit for the year	–	300 000	189 000
Other comprehensive income	3 136	–	–
Dividends: None	–	–	–
Balance at 31 December 20.29	R10 976	R506 000	R405 500

Additional information

- 1 P Ltd bought 15 000 shares in S Ltd on 1 January 20.27 for R40 000.
- 2 S Ltd became a subsidiary of P Ltd on 1 March 20.29, when P Ltd bought another 60 000 shares in S Ltd for R216 000.
- 3 P Ltd elected to measure non-controlling interests at fair value at the date of acquisition. The fair value of the non-controlling interests was R90 000 at the acquisition date (when P Ltd obtained control over S Ltd).
- 4 On the date of the business combination, the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3.

- 5 P Ltd classified the investment in S Ltd at cost in its separate financial statements after it became a subsidiary. The group's accounting policy is to regard the fair value of the previously held investment, plus the consideration for the additional purchase whereby control over S Ltd was obtained, as the cost of the investment in the subsidiary under IAS 27.

Before S Ltd became a subsidiary, P Ltd classified the investment under IFRS 9 in its separate financial statements as subsequently measured at fair value through other comprehensive income. P Ltd recognised fair value adjustments in the mark-to-market reserve (other comprehensive income). Any amount in the mark-to-market reserve is transferred to retained earnings with the disposal of the underlying investment.

Details of the 15% investment are as follows:

Number of shares	Fair value on 1/1/20.27	Fair value on 1/1/20.29	Fair value on 1/3/20.29
15 000	R40 000	R50 000	R54 000

- 6 The profit of S Ltd was earned evenly during the current year ended 31 December 20.29.
- 7 The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof.

Solution 13.2

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29	
ASSETS	
Non-current assets	
Property, plant and equipment (400 000(P) + 505 500(S))	905 500
Goodwill	12 000
Total assets	R917 500
EQUITY AND LIABILITIES	
Share capital	150 000
Retained earnings	635 101
	785 101
Non-controlling interests	129 375
Total equity	914 476
Liabilities	
Deferred tax	3 024
Total equity and liabilities	R917 500

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29	
Revenue $(700\,000(P) + 600\,000(S) - 100\,000(J2))$ or $(700\,000(P) + 600\,000 \times 10/12(S))$	1 200 000
Cost of sales $(280\,000(P) + 240\,000(S) - 40\,000(J2))$ or $(280\,000(P) + 240\,000 \times 10/12(S))$	(480 000)
Gross profit $(420\,000(P) + 360\,000 \times 10/12(S))$	720 000
Other expenses $(90\,000(S) - 15\,000(J2))$ or $(90\,000 \times 10/12(S))$	(75 000)
Profit before tax	645 000
Income tax expense $(120\,000(P) + 81\,000(S) - 13\,500(J2))$ or $(120\,000(P) + 81\,000 \times 10/12(S))$	(187 500)
PROFIT FOR THE YEAR	457 500
Other comprehensive income:	
Items that will not be reclassified to profit or loss:	
Mark-to-market reserve (fair value adjustment to investment) (before the business combination)	4 000
Income tax relating to items that will not be reclassified	(864)
Other comprehensive income for the year, net of tax	3 136
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R460 636
Profit attributable to:	
Owners of the parent	418 125
Non-controlling interests (#)	39 375
	R457 500
Total comprehensive income attributable to:	
Owners of the parent $(418\,125(\text{profit}) + 3\,136(\text{OCI}))$	421 261
Non-controlling interests (#)	39 375
	R460 636

(#) The same as profit for the year, as the non-controlling interests do not share in the other comprehensive income in this example.

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29						
	Share capital	Retained earnings	Mark-to-market reserve	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.29	150 000	206 000	* 7 840	363 840	–	363 840
Changes in equity for 20.29						
Acquisition of subsidiary	–	–	–	–	! 90 000	90 000
Total comprehensive income for the year:						
Profit for the year	–	418 125	–	418 125	39 375	457 500
Other comprehensive income	–	–	3 136	3 136		3 136
Transfer (J1)	–	10 976	(10 976)	–	–	–
Balance at 31 Dec 20.29	R150 000	R635 101	–	R785 101	R129 375	R914 476

* $(50\,000 - 40\,000) \times 78,4\% = 7\,840$
! $87\,000 + 3\,000(\text{represented by goodwill}) = 90\,000$

	Comments	
	The amounts in the mark-to-market reserve can be explained as follows:	
	Opening balance after tax $(50\,000 - 40\,000) \times 78,4\%$	7 840
	Recognised in other comprehensive income for the year:	3 136
	Movement for the period 1/1/20.29 – 28/2/20.29, after tax $(54\,000 - 50\,000) \times 78,4\%$	3 136
	Movement for the period 1/3/20.29 – 31/12/20.29 – investment in subsidiary was now held at “cost”, and there were no subsequent remeasurements	–
	Transferred to retained earnings on the date of acquisition, after tax $(54\,000 - 40\,000) \times 78,4\%$ as if the investment was disposed of (IFRS 3.42)	(10 976)
Closing balance		<u>Rnil</u>

Calculations**C1 Analysis of the owners' equity of S Ltd**

	Total	P Ltd 15%–75%		NCI
		At	Since	
i At acquisition (1/3/20.29)				
Share capital	100 000	75 000		25 000
Retained earnings at acquisition	248 000	186 000		62 000
As at beginning of year	216 500			
Profit for the period 1/1/20.29– 28/2/20.29 (189 000 × 2/12)	31 500			
	348 000	261 000		87 000
Equity represented by goodwill – Parent and NCI	12 000	9 000		3 000
Consideration and NCI	360 000	270 000		90 000
Consideration paid for additional shares purchased		216 000		
Fair value of equity interest previously held		54 000		
ii Since acquisition				
• Current year:				
Profit: 1/3/20.29–31/12/20.29 (189 000 × 10/12)	157 500		118 125	39 375
Dividends: None	–		–	–
	R517 500		R118 125	R129 375

**Comments**

- a The retained earnings **at acquisition** of S Ltd comprises of the balance at the beginning of the year and the net profit for the first two months up to the date of the business combination. Refer to chapter 8 dealing with the interim acquisition of a subsidiary (i.e. acquisition of control during the current year) for more detail in this regard.
- B The **consideration** for the business combination (gaining control over S Ltd) comprises of the amount paid for the additional shares (R216 000) and the fair value of the equity interest previously held (R54 000). In terms of IFRS 3.42, P Ltd should remeasure its previous investment of 15 000 shares to the fair value of R54 000 at the date of acquisition.

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	216 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	90 000
Acquisition-date fair value of acquirer's previously held equity interest in the acquiree: IFRS 3.32(a)(iii)	54 000
	<u>360 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(348 000)
Goodwill (parent and NCI)	<u>R12 000</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Mark-to-market reserve (SCE) ((54 000 – 40 000) × 78,4%) (comment (b)) Retained earnings (SCE) Transfer of fair value adjustments previously recognised in mark-to-market reserve (OCI) to retained earnings with the deemed disposal of equity interest previously held, at the group level	10 976	10 976
J2	Share capital (SCE) Retained earnings – Opening balance (SCE) (comment (c)) Goodwill (SFP) (parent and NCI) Revenue (P/L) (comment (c)) (600 000 × 2/12) Cost of sales (P/L) (comment (c)) (240 000 × 2/12) Other expenses (P/L) (comment (c)) (90 000 × 2/12) Income tax expense (P/L) (comment (c)) (81 000 × 2/12) Investment in S Ltd (SFP) (54 000 + 216 000) Non-controlling interests (SCE) Main elimination journal entry at acquisition date	100 000 216 500 12 000 100 000	40 000 15 000 13 500 270 000 90 000
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Non-controlling interests' portion of current year's profit (1/3/20.29–31/12/20.29, i.e. after additional acquisition)	39 375	39 375

**Comments**

- a S Ltd only became a subsidiary on 1 March 20.29. Thereafter, P Ltd elected to measure its investment in the subsidiary at cost in its separate financial statements, and there were no further remeasurements to fair value after this date.
- b In terms of IFRS 3.42, P Ltd should first remeasure its previous investment of 15 000 shares to the fair value of R54 000 at the date of acquisition, as is indicated in the analysis above. Furthermore, P Ltd already recognised the resulting fair value adjustments with the remeasurement in other comprehensive income under IFRS 9 in its separate financial statements. Then, for the **group**, the cumulative fair value gains previously recognised in the mark-to-market reserve (OCI) are transferred to retained earnings on the date of acquisition. It is assumed that this transfer (J1) is only made at the group level (as part of the pro forma consolidation adjustments) for the deemed disposal of the previously held investment. P Ltd did not actually dispose of any investment. Therefore, the transfer is not reflected in P Ltd's separate financial statements. IFRS 3 basically treats the previously held investment as being disposed of at fair value and a new subsidiary acquired at fair value. Note that there are no actual tax consequences as there is no actual sale (only a deemed disposal for the sake of the group's consolidated financial statements).

The cost of the original investment was R40 000. The fair value of this investment on 1 March 20.29 was R54 000, which resulted in a cumulative fair value gain of R14 000 before tax. The after-tax amount of R10 976 is transferred within equity, similar to the accounting treatment as if the investment would have been derecognised (IFRS 9.B5.7.1).

- c To prepare the consolidated financial statements, the financial statements of S Ltd are combined (consolidated) with the financial statements of P Ltd (i.e. adding every line item in the financial statements of S Ltd to that of P Ltd). This implies that the whole amount (i.e. for the full year) of all items of profit or loss is added to that of P Ltd. S Ltd was not a subsidiary of P Ltd for the first two months. The profit earned during these two months should not form part of the profit or loss for the group and should be eliminated from the group's profit or loss. The profits for the first two months are actually part of the reserves at the acquisition date and should be eliminated as such in accounting for the business combination. Refer to chapter 8 dealing with the interim acquisition of a subsidiary (i.e. acquisition of control during the current year) for more detail in this regard.
- d Full disclosure of the business combination should be made in terms of IFRS 3.59–63 and B64–B67. Of particular interest to this example is the disclosure of the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date (being R54 000) and the amount of the gain recognised as a result of remeasuring the equity interest in the acquiree held before the business combination to fair value (being the transfer of the cumulative gain of R10 976 within equity – see journal 1).

13.5 Acquisition of an additional interest whereby an associate becomes a subsidiary

- 1 The section above dealt with a business combination achieved in stages where the acquirer obtains an additional interest in an existing investee. The status of the investment changed from a simple investment to an investment in a subsidiary. The same principles and disclosure requirements will also be applicable where an associate or joint venture becomes a subsidiary.

- 2 An investor may have obtained an interest in an investee whereby significant influence is exerted. Where the acquirer then obtains an additional interest in an associate, whereby control is obtained, the business combination should be accounted for in terms of IFRS 3.41 and .42. With regards to an associate or joint venture that becomes a subsidiary during the current period, the following consolidation procedures will be relevant:
- ☐ up to the acquisition date, the investment in the associate or joint venture should be accounted for in terms of the **equity method** (note that all investments in associates and joint ventures must be accounted for in terms of the equity method, unless one of the exceptions in IAS 28.17 applies, in which case the investment will be measured in terms of **IFRS 9 Financial Instruments**);
 - ☐ where the investor/parent accounted for the investment in the associate, joint venture and subsidiary in accordance with IFRS 9 at fair value in its **separate** financial statements, **any fair value adjustments** must be reversed upon consolidation (an investment in an associate, joint venture or subsidiary may be accounted for **at cost** (which is arguably the most common approach in South Africa) or in accordance with IFRS 9 in the investor's separate financial statements – refer to IAS 28.44 and IAS 27.10);
 - ☐ the previously held equity interest in the acquiree (now being the carrying amount of the associate or joint venture under the equity method, as above) should be **remeasured** at its acquisition-date fair value, and the resulting gain or loss, if any, recognised in **profit or loss** directly (as if the interest in the associate or joint venture was disposed of and a controlling interest purchased (IFRS 3.42) – then follow IAS 28.22 for the deemed disposal of the associate or joint venture);
 - ☐ in terms of the equity method, the investor may have recognised its share of items recognised in **other comprehensive income** of the associate or joint venture. If so, these amounts that were previously recognised in other comprehensive income shall be recognised as if the acquirer had disposed directly of the previously held equity interest (as with any asset). Depending on the nature of underlying assets remeasured or revalued in other comprehensive income, some of these items will be reclassified from other comprehensive income to profit or loss (e.g., the foreign currency translation reserve – refer to chapter 16), and some items will only be transferred within equity (e.g., the revaluation surplus on property, plant and equipment and the mark-to-market reserve on equity investments (if so elected) transferred to retained earnings);
 - ☐ **remeasurement** of identifiable net assets in terms of IFRS 3 (see chapters 2 and 9), where applicable;
 - ☐ **elimination of common items** at the acquisition date and the recognition and measurement of any goodwill or bargain gain and non-controlling interests (it should be noted that the retained earnings or reserves that will be eliminated at the acquisition date would comprise of the opening balances at the beginning of the year, the net profit for the period of the current year (various line items in the statement of profit or loss), and the items in other comprehensive income before the acquisition date – similar to the interim acquisition of a subsidiary that was addressed in chapter 8); and
 - ☐ applying basic **consolidation principles** after the acquisition date.

Example 13.3

Acquisition of a further interest where an associate becomes a subsidiary (control is obtained) (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)

On 31 December 20.22, the following summarised financial information relating to P Ltd and other wholly-owned subsidiaries (consolidated) and S Ltd is supplied:

SUMMARISED FINANCIAL INFORMATION AS AT 31 DECEMBER 20.22		
	P Ltd and sub- sidiaries (consoli- dated)	S Ltd
DEBITS		
Property, plant and equipment	50 000	9 000
Investment in S Ltd at cost:		
8 000 shares purchased on 1/1/20.21 (consideration)	8 000	—
5 000 shares purchased on 30/4/20.22 (consideration)	7 500	—
Inventory	144 500	31 000
Cost of sales (*)	8 000	3 000
Income tax expense (*)	2 000	1 000
	R220 000	R44 000
CREDITS		
Share capital (150 000/20 000 shares)	150 000	20 000
Retained earnings: 1/1/20.22	50 000	4 000
Revaluation surplus	—	1 000
Sundry liabilities (including deferred tax)	—	9 000
Revenue (*)	20 000	10 000
	R220 000	R44 000

(*) Accrued/incurred evenly

Additional information

- 1 P Ltd acquired 8 000 shares (40% interest) in S Ltd at the incorporation of S Ltd on 1 January 20.21. On 30 April 20.22, P Ltd purchased a further 5 000 shares (25% interest) in S Ltd from the non-controlling owner, thereby obtaining control over the voting rights of S Ltd. P Ltd now holds a 65% interest in S Ltd.
- 2 At the acquisition date (i.e. the date on which P Ltd obtained **control** of S Ltd), the assets and liabilities of S Ltd were regarded as a fair reflection in terms of the requirements of IFRS 3. The acquisition-date fair value of P Ltd's previously held equity interest was R11 100.
- 3 P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date.
- 4 P Ltd accounts for all investments in associates in accordance with the equity method in its **consolidated financial statements**, as none of the exceptions in IAS 28.17 applies.

- 5 On 31 December 20.21, S Ltd revalued its land and recognised a surplus of R1 000 (after tax) in the revaluation surplus (OCI) in its individual financial statements. It is the policy of the group to realise the revaluation surplus when the asset is sold. The next revaluation will be done on 31 December 20.24.
- 6 P Ltd measures the investment in S Ltd (as an associate and as a subsidiary) at **cost** in terms of IAS 27.10(a) in its separate financial statements.
- 7 The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof.



Comments

The total amount for the investment in the subsidiary within the parent's separate records amounts to R15 500 (applying the accumulated cost approach, as P Ltd's investments in associates and subsidiaries are carried at **cost** in the investor's/parent's separate financial statements under IAS 27). The parent may have remeasured the previously held investment to its fair value at the date of the business combination, with any gain or loss recognised in profit or loss (refer to the IFRIC Update of January 2019). Still, such remeasurement gain or loss would be reversed before the equity accounting and pro forma consolidation journals below would be performed.

Solution 13.3

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.22	
ASSETS	
Non-current assets	
Property, plant and equipment (50 000(P) + 9 000(S))	59 000
Goodwill (parent)	1 050
	60 050
Current assets	
Inventory (144 500(P) + 31 000(S))	175 500
Total assets	R235 550
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	150 000
Retained earnings	65 700
	215 700
Non-controlling interests (10 850(S))	10 850
Total equity	226 550
Liabilities (9 000(S))	9 000
Total equity and liabilities	R235 550

P LTD GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS
AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.22

Revenue (20 000(P) + 10 000(S) – 3 333(J5))	26 667
Cost of sales (8 000(P) + 3 000(S) – 1 000(J5))	(10 000)
Gross profit	16 667
Other income (remeasurement gain) (J3)	300
Share of profit of associate (J2)	800
Profit before tax	17 767
Income tax expense (2 000(P) + 1 000(S) – 333(J5))	(2 667)
PROFIT FOR THE YEAR	15 100
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R15 100
Profit attributable to:	
Owners of the parent	13 700
Non-controlling interests (last eight months of current period) (J6)	1 400
	R15 100
Total comprehensive income attributable to:	
Owners of the parent	13 700
Non-controlling interests (last eight months of current period) (J6)	1 400
	R15 100

P LTD GROUP
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.22

	Share capital	Retained earnings	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.22	150 000	* 51 600	# 400	202 000	–	202 000
Changes in equity for 20.22						
Acquisition of subsidiary	–	–	–	–	9 450	9 450
Transfers	–	400	(400)	–	–	–
Total comprehensive income for the year:						
Profit for the year	–	13 700	–	13 700	1 400	15 100
Balance at 31 Dec 20.22	R150 000	R65 700	–	R215 700	R10 850	R226 550

* 50 000(P) + 1 600(S) = 51 600

400(S)

Calculations

C1.1 Analysis of the owners' equity of S Ltd – as associate

	Total	P Ltd 40%		NCI
		At	Since	
i Date of first purchase				
Share capital	20 000	8 000		12 000 *
Retained earnings	–	–		–
	20 000	8 000		12 000 *
Consideration		8 000		
ii Since date of first purchase				
• To beginning of current year:				
Retained earnings (4 000 – 0)	4 000		1 600 RE	2 400 *
Revaluation surplus	1 000		400 RS	600 *
• Current year:				
Profit: 1/1/20.22–30/4/20.22 (6 000 × 4/12 = 2 000 (accrued evenly))	2 000		800 RE	1 200 *
	27 000		2 800	16 200 *
Associate becomes a subsidiary				
Derecognise associate (IFRS 3.BC384)	(27 000)	(8 000)	(2 800)	
Transfer between reserves (400 RE – 400 RS) (comment (d))	–	–	400 RE (400)RS	–
	–		–	–

* See comment (c)

RE = retained earnings; RS = revaluation surplus

C1.2 Analysis of the owners' equity of S Ltd – as subsidiary

	Total	P Ltd 65%		NCI
		At	Since	
i At acquisition (30 April 20.22)				
Share capital	20 000	13 000		7 000
Retained earnings at beginning of year	4 000	2 600		1 400
Profit for the current year before acquisition ($6\,000 \times 4/12 = 2\,000$)	2 000	1 300		700
Revaluation surplus	1 000	650		350
Total equity acquired	27 000	17 550		9 450
Equity represented by goodwill – Parent	1 050	1 050		–
Consideration and NCI	28 050	18 600		9 450
Consideration paid for additional shares purchased (25%)		7 500		
Fair value of equity interest previously held (40%) (comment (b))		11 100		
ii Since acquisition				
Profit: 1/5/20.22–31/12/20.22 ($6\,000 \times 8/12 = 4\,000$ (accrued evenly))	4 000		2 600 RE	1 400
	R32 050		R2 600 RE	R10 850

RE = retained earnings



Comments

- a The retained earnings **at acquisition** of S Ltd comprises of the balance at the beginning of the year and the net profit for the first four months up to the date of the business combination. Refer to J5 I comment (c) to the journal entries.
- b The **consideration** for the business combination (gaining of control over S Ltd) comprises of the amount paid for the additional shares and the fair value of the equity interest previously held. In terms of IFRS 3.42, P Ltd should re-measure its equity interest previously held (i.e. investment in associate) to the **fair value of R11 100** at the date of acquisition. Note that the **carrying amount** of the investment in S Ltd (previously held equity interest) at the acquisition date (in the consolidated financial statements) is **R10 800** (i.e. R8 000 (cost) + R1 600 (share in retained earnings) + R400 (share in revaluation surplus) + R800 (current-period share of profit of associate)). The investment is remeasured to R11 100, and a **remeasurement gain of R300** (11 100 – 10 800) is recognised in the consolidated financial statements – refer to J3 below. This is the same treatment **as if** the associate (with a carrying amount of R10 800) was sold at its fair value of R11 100.

In this example, all the assets and liabilities of S Ltd were regarded as fairly valued at the date of the business combination, and no adjustment to the individual assets and liabilities in terms of IFRS 3 was needed.
- c Before 30 April 20.22 (the acquisition date), S Ltd is only an associate of P Ltd, and the non-controlling interests are not recognised as such. These amounts (*) are given for information purposes only as S Ltd only became a subsidiary at the acquisition date, and the non-controlling interests are then recognised. In this example, the non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date as R9 450 (27 000 × 35%). IFRS 3.B64(o)(i) only requires disclosure of the amount of the non-controlling interests in the acquiree recognised at the acquisition date (i.e. R9 450).
- d In terms of IFRS 3.42 and IAS 28.22(c), any amount previously recognised in other comprehensive income (i.e. the revaluation surplus) shall be recognised on the same basis as would be required if the acquirer had disposed of directly of the previously held equity interest. In terms of IAS 16.41, a revaluation surplus may be transferred directly to retained earnings when the asset is derecognised. Also, see J4 below.

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	7 500
Amount of non-controlling interests:	
IFRS 3.32(a)(ii) (27 000 × 35%) or (16 200 × 35/60)	9 450
Acquisition-date fair value of acquirer's previously held equity interest in the acquiree: IFRS 3.32(a)(iii) (given)	11 100
	28 050
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(27 000)
Goodwill (parent)	R1 050

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in S Ltd (associate) (SFP) (comment (a)) Retained earnings (SCE) Revaluation surplus (SCE) Accounting for investor's interest in reserves of associate at the beginning of the year	2 000	1 600 400
J2	Investment in S Ltd (associate) (SFP) (comment (a)) Share of profits of associate (P/L) Accounting for investor's share of current year's profit (1/1/20.22–30/4/20.22, i.e. before additional acquisition) of associate	800	800
J3	Investment in S Ltd (associate) (SFP) (comment (b)) Other income (remeasurement gain) (P/L) Accounting for remeasurement gain on equity interest previously held	300	300
J4	Revaluation surplus (SCE) (comment (d) above) Retained earnings (SCE) Transfer of the equity-accounted revaluation surplus to retained earnings with business combination	400	400
J5	Share capital (SCE) Retained earnings – Opening balance (SCE) (comment (c)) Revaluation surplus (SCE) Goodwill (SFP) (parent) Revenue (P/L) (comment (c)) (10 000 × 4/12) Cost of sales (P/L) (comment (c)) (3 000 × 4/12) Income tax expense (P/L) (comment (c)) (1 000 × 4/12) Investment in S Ltd (SFP) (now subsidiary) (8 000(initial cost) + 2 000(J1) + 800(J2) + 300(J3) + 7 500(additional cost)) or (11 100 + 7 500) Non-controlling interests (SCE) Main elimination journal entry at acquisition date	20 000 4 000 1 000 1 050 3 333	1 000 333 18 600 9 450
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Non-controlling interests' portion of current year's profit (1/5/20.22–31/12/20.22, i.e. after additional acquisition)	1 400	1 400



Comments

- a Journal 1 and 2 are typical journal entries for the accounting of associates in terms of the equity method (see chapter 11 for detail).
- b Journal 3 represents the adjustment of the equity interest previously held to fair value, with the recognition of the remeasurement gain in the consolidated financial statements in terms of IFRS 3.42.
- c To prepare the consolidated financial statements, the financial statements of S Ltd are combined (consolidated) with the financial statement of P Ltd (i.e. adding every line item in the financial statement of S Ltd to those of P Ltd). This implies that the whole amount (i.e. for the full year) of all items of profit or loss is added to that of P Ltd. S Ltd was not a subsidiary of P Ltd for the first four months, and the profit earned during these four months should not form part of the profit or loss for the group and should be eliminated from the group's profit or loss. The profits for the first four months are actually part of the reserves at the acquisition date and should be eliminated as such in accounting for the business combination. Refer to chapter 8 dealing with the interim acquisition of a subsidiary (i.e. acquisition of control during the current year) for more detail in this regard.
- d Full disclosure of the business combination should be made in terms of IFRS 3.59–63 and B64–B67. Of particular interest to this example is the disclosure of the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date (being R11 100), and the amount of the gain recognised as a result of remeasuring to fair value the equity interest in the acquiree held before the business combination (being the gain of R300 included in the line item for “other income”).

Disposal of interests in a subsidiary

13.6 Basic approach on disposal of an interest

- 1 The disposal of interests in a subsidiary (whether entirely or partially) by a parent is materially similar to the disposal of any other asset by the parent. The transaction consists of the following components:
 - ☐ the recognition of the asset received for the disposal (e.g. cash proceeds);
 - ☐ derecognition of the carrying amount of the asset disposed of from the asset account (e.g. the investment held in another entity is derecognised); and
 - ☐ recognition of any gain or loss on disposal (either in profit or loss or directly in equity, depending on whether control has been lost).
- 2 In the **separate** financial statements of the parent, the gain or loss on the disposal of the shares is calculated in accordance with the **cost method** or **fair value method** (depending on the accounting policy applied by the parent for the measurement of investments in subsidiaries in its separate financial statements – IAS 27.10). This policy decision will affect the accounting for the disposal of a parent's interest in a subsidiary:
 - ☐ If the parent has accounted for the investment in the subsidiary in its **separate** financial statements at **cost**, the gain or loss on the disposal of its interest is calculated purely as the difference between the proceeds from the disposal of the shares and the historical cost price of the shares disposed of. The gain or loss is recognised in **profit or loss**.



Comments

This work focuses on the investment in a subsidiary, associate or joint venture carried at **cost** in the parent's/investor's separate financial statements, as it is arguably the most common approach applied by companies in South Africa.

- ☐ If the parent has accounted for the investment in the subsidiary in its **separate** financial statements in accordance with **IFRS 9**, the investment would be measured at **fair value** at any given time. The parent may choose to remeasure the investment to fair value through other comprehensive income (refer to IFRS 9.5.7.5). If the parent elected this alternative, it could furthermore choose to **transfer** the cumulative fair value adjustments recognised in other comprehensive income, **to retained earnings** when the investment is sold (IFRS 9.B5.7.1).
- 3 However, for the **group (consolidated)**, the disposal of the parent's interest will be dealt with differently. In the group context, the disposal of the shares comprises the disposal of:
 - ☐ an attributable interest in the **net assets** (i.e. equity) of the subsidiary as at the date of the transaction; as well as
 - ☐ a proportionate portion of the goodwill or gain from a bargain purchase (the latter will form part of the equity recognised since the acquisition date).

It is apparent that, with reference to the "at-acquisition section" of the **analysis of owners' equity** of a subsidiary, the cost price of the shares is equal to the fair value of the attributable net assets (equity) as at the acquisition date plus (or minus) the goodwill (or gain from a bargain purchase). Consequently, the following applies:

 - ☐ gain/loss on disposal of shares in a subsidiary per the **separate** financial statements of the parent (calculated in accordance with the cost method)

less

 - ☐ attributable reserves earned **since acquisition** (which evidences an increase/decrease in the net asset value since the acquisition date) now given up due to the disposal of the shares

equals

 - ☐ gain/loss on disposal of **interest** in the group context (refer to comment (g) to the analysis in example 13.4a).



Comments

Net asset value as at the acquisition date **plus** reserves to the date of disposal **equals** the net asset value as at the date of the disposal.

- 4 The accounting treatment of the parent's disposal of an interest in the subsidiary depends on whether **control over the subsidiary is lost or not**. IFRS 10 contains detailed requirements for both cases, and these requirements are discussed and illustrated in the sections below. IFRS 10.23 would be applicable in the case where control is not lost, and IFRS 10.25 where control is lost.

13.7 Partial disposal of an interest in a subsidiary where control is not lost

- 1 IFRS 10.23 states that **changes in a parent's owners' equity** in a subsidiary that **do not result in a loss of control** are accounted for as **equity transactions** (i.e. transactions with owners in their capacity as owners). It should be borne in mind that non-controlling interests are also classified as equity (IFRS 10.22). Furthermore, the **consolidated carrying amounts** of the parent's and non-controlling interests must be adjusted to reflect the change in their relative interests in the subsidiary. This change in the relative interests of the owners shall be recognised **directly in equity** and is attributable to the owners of the parent. This means that no gain or loss should be recognised in profit or loss where a parent disposes some of its interest in a subsidiary without losing control (i.e. the subsidiary remains a subsidiary of the parent, but the parent's interest in the subsidiary declined).

This transaction only changes the parent's and non-controlling shareholders' **relative interests** in the subsidiary and is therefore recognised only within equity. This means that no change in the carrying amount of the subsidiary's assets (including goodwill) or liabilities is recognised.



Comments

It is important to note that the parent's and non-controlling interests in the **consolidated carrying amount** of the subsidiary are re-calculated, and that there is no remeasurement to fair value (as with the loss of control over a subsidiary – refer to paragraph 13.8 and 13.9 below). The consolidated carrying amount relating to the subsidiary is calculated after any adjustments with the business combination and any normal consolidation adjustments were made. Furthermore, the adjustment for the change in the ownership interest is made directly within **equity**, and no gain or loss is recognised in the consolidated profit or loss for the group.

- 2 When a parent sells a portion of its investment in a subsidiary (but retains control), the parent would recognise a gain or loss on the disposal in its **separate statement of profit or loss** (if the investment was carried at cost) or as a transfer within equity in its **separate statement of changes in equity** (if the investment was accounted for in accordance with IFRS 9). This gain or loss or the transfer within equity will be **reversed** upon consolidation.

The amount for the **consolidated gain or loss** for the group may be different from that of the parent and must be recognised directly in **equity**. In preparing the consolidated financial statements, the **adjustment to the non-controlling interests** (reflecting the change in their relative interest in the equity of the subsidiary) will also need to be reflected in the **consolidated statement of changes in equity**. This approach will also be evident from the pro forma consolidation journal entries in the example below (see journal 4).

- 3 IFRS 10.B96 states that the amount to be recognised in equity would be the difference between the amount by which the **non-controlling interests** is adjusted and the fair value of the consideration paid or received. This adjustment in the amount of the non-controlling interests will be affected by the initial measurement of the non-controlling interests at the date of the business combination (at their proportionate share of the acquiree's identifiable net assets or at fair value – see comment (f) to the analysis in example 13.4a for more detail), which is illustrated in the examples below.

It was mentioned in paragraph 13.3 above that the approach for calculating the adjustment to the non-controlling interests is based on the view that the subsidiary basically consists of two separate asset pools: one asset pool in respect of all the **other net assets** (excluding goodwill); and **goodwill** (which may be recognised only in respect of the parent's interest or for both the parent's and the non-controlling interests'). With a partial sale of an interest in a subsidiary by the parent (without losing control), the equity represented by the other net assets will always be re-attributed between the parent and the non-controlling interests based on their new ownership interests. The **equity represented by goodwill will only be re-attributed between the parent and the non-controlling interests if goodwill was initially measured in respect of the non-controlling interests** (i.e. the non-controlling interests were initially measured at fair value). This approach is illustrated in calculation 4 of the following two examples.

- 4 **Disclosure** of a schedule that shows the **effect on the equity** attributable to owners of the parent of any changes in its ownership interest in a subsidiary that did not result in a loss of control, should be made in terms of IFRS 12.18. Refer to paragraph 13.3 of this chapter for more detail.

Example 13.4a	Partial disposal of an interest in a subsidiary with no change in the status as the subsidiary remains a subsidiary (control is not lost) (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)
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The following represents the condensed financial statements of P Ltd and its subsidiary at 31 December 20.25:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.25		
	P Ltd	S Ltd
ASSETS		
Inventory	70 000	100 000
Bank	63 150	60 000
Investment in S Ltd: 6 000 shares at cost (R40 000 – R10 000)	30 000	–
Total assets	R163 150	R160 000
EQUITY AND LIABILITIES		
Share capital (90 000/10 000 shares)	90 000	10 000
Replacement reserve (comment (a))	–	120 000
Retained earnings	73 150	30 000
Total equity and liabilities	R163 150	R160 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.25		
	P Ltd	S Ltd
Revenue	100 000	80 000
Cost of sales	(67 000)	(56 000)
Gross profit	33 000	24 000
Other income (profit on the sale of shares)	25 000	–
Profit for the year before tax	58 000	24 000
Income tax expense	(14 850)	(9 000)
PROFIT FOR THE YEAR	43 150	15 000
Other comprehensive income	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R43 150	R15 000

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.25		
	Retained earnings	
	P Ltd	S Ltd
Balance at 1 January 20.25	30 000	15 000
Changes in equity for 20.25		
Total comprehensive income for the year:		
Profit for the year	43 150	15 000
Other comprehensive income	–	–
Balance at 31 December 20.25	R73 150	R30 000

Additional information

- P Ltd acquired its 80% interest (8 000 shares) in S Ltd on 1 January 20.21 for R40 000. On that date S Ltd's equity consisted of the following:

Share capital	R10 000
Replacement reserve	R30 000
Retained earnings	R5 000
- P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. On the date of the business combination, the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3.
- P Ltd classified the investment in S Ltd at cost in its separate financial statements.

- 4 On 30 June 20.25, P Ltd disposed of 2 000 of the shares in S Ltd for R35 000 (fair value). P Ltd accounted for the cash proceeds from the disposal of the interest as follows in its **separate** financial statements:

		Dr R	Cr R
J1	Bank (SFP) Investment in S Ltd (SFP) (2 000/8 000 shares × R40 000 cost) Profit on sale of shares (P/L) Recording proceeds and profit on partial disposal of investment	35 000	10 000 25 000
J2	Income tax expense (P/L) SARS tax payable/Bank (SFP) (25 000 × 80% × 27%) Capital gains tax (current tax) payable on disposal of shares	5 400	5 400

- 5 The disposal of the interest in the subsidiary did not comply with the criteria of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** until the date of disposal.
- 6 The profit of S Ltd was earned evenly during 20.25.
- 7 S Ltd made no transfer to/from the replacement reserve during the current year.
- 8 The company tax rate is 27% and CGT is calculated at 80% thereof.

	Comments
a Although the Companies Act does not require specific reserves to be created, it is assumed that a company may well create any reserve by choice (as a transfer within equity, i.e. from retained earnings to a reserve). In this example, it was assumed that S Ltd created a replacement reserve in the past to replace assets that were fully depreciated during the current period, in the next year. The reserve is merely used to illustrate the effect of a partial sale of an interest in a subsidiary on other reserves (other than retained earnings). b There are various ways in which the partial disposal of the investment can be recognised in the investor's separate financial statements. When share disposals take place, the separate financial statements of the parent may contain an item such as a "suspense account" to which the proceeds on disposal have been provisionally credited (and not as was done in note 4 of this example). If this is the case, the separate financial statements of the parent (P Ltd) must first be corrected by some actual correcting journal entries (i.e. not pro forma consolidation journal entries) to achieve the entries indicated in note 4 above.	

Solution 13.4a

In this example, P Ltd retained control over S Ltd, even though it sold some of its interest in S Ltd to the non-controlling interests. P Ltd, therefore, combines its financial statements and those of S Ltd (as a subsidiary) line by line by adding together like items of assets, liabilities, equity, income and expenses (IFRS 10.B86(a)). Thereafter, the normal consolidation principles will be followed to eliminate common items and to recognise any non-controlling interests and goodwill.

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.25	
ASSETS	
Non-current assets	
Goodwill (parent only)	4 000
Current assets	
Inventory (70 000(P) + 100 000(S))	170 000
Bank (63 150(P) + 60 000(S))	123 150
	293 150
Total assets	R297 150
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	90 000
Retained earnings	84 650
Other components of equity (54 000 + 4 500)	58 500
	233 150
Non-controlling interests	64 000
Total equity	297 150
Total equity and liabilities	R297 150

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.25	
Revenue (100 000(P) + 80 000(S))	180 000
Cost of sales (67 000(P) + 56 000(S))	(123 000)
Gross profit	57 000
Other income (no gain on disposal of interest is recognised here) (25 000(P) – 25 000(J4))	–
Profit before tax	57 000
Income tax expense (14 850(P) + 9 000(S))	(23 850)
PROFIT FOR THE YEAR	33 150
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R33 150
Profit attributable to:	
Owners of the parent	28 650
Non-controlling interests (1 500 + 3 000) (#)	4 500
	R33 150
Total comprehensive income attributable to:	
Owners of the parent	28 650
Non-controlling interests (1 500 + 3 000) (#)	4 500
	R33 150

(#) The same as profit for the year, as there is no other comprehensive income in the example.

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.25							
	Share capital	Changes in ownership	Re-tained earnings	Re-place-ment reserve	Total	Non-con-trolling interests	Total equity
Balance at 1 Jan 20.25	90 000	–	* 38 000	72 000	200 000	! 29 000	229 000
Changes in equity for 20.25							
Total comprehensive income for the year:							
Profit for the year	–	–	28 650	–	28 650	4 500	33 150
Transfer from replacement reserve	–	–	18 000	(18 000)	–	–	–
Disposal of interest	–	4 500	–	–	4 500	30 500	35 000
Balance at 31 Dec 20.25	R90 000	R4 500	R84 650	R54 000	R233 150	R64 000	R297 150

* 30 000(P) + 8 000(S) = 38 000

! 9 000(at) + 2 000(RE) + 18 000(RR) = 29 000

P LTD GROUP NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	
Changes in ownership in subsidiary: During the current year, P Ltd sold a 20% interest in S Ltd, an existing subsidiary, without losing control over S Ltd. This resulted in an amount of R4 500 being recognised in equity as presented in the consolidated statement of changes in equity. Details of the transaction between the equity participants are as follows: Fair value of the consideration received Increase in the non-controlling interests Adjustment to equity attributable to owners of the parent	35 000 (30 500) R4 500

Calculations

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 80%–60%		NCI
		At	Since	
i At acquisition (1/1/20.21)				
Share capital	10 000	8 000		2 000
Replacement reserve	30 000	24 000		6 000
Retained earnings	5 000	4 000		1 000
	45 000	36 000		9 000
Equity represented by goodwill – Parent	4 000	4 000		–
Consideration and NCI	49 000	40 000		9 000
ii Since acquisition				
• To beginning of current year:				
Retained earnings (15 000 – 5 000)	10 000		8 000 RE	2 000
Replacement reserve (120 000 – 30 000)	90 000		72 000 RR	18 000
• Current year:				
Profit: 1/1/20.25–30/6/20.25 (15 000 × 6/12)	7 500		6 000 RE	1 500
	156 500		14 000 RE 72 000 RR (3 500) RE (18 000) RR	30 500
Disposal of 2 000 shares (1) (comment (b))		(9 000)		30 500
	156 500			61 000
Profit: 1/7/20.25–31/12/20.25 (15 000 × 6/12)	7 500		4 500 RE	3 000
	R164 000		R15 000 RE	R64 000
			R54 000 RR	

RE = Retained earnings

RR = Replacement reserve

(1) $36\,000 \times 20/80 = 9\,000$ AT

$(8\,000 + 6\,000) \times 20/80 = 3\,500$ RE

$72\,000 \times 20/80 = 18\,000$ RR

$30\,500(\text{NCI}) \times 40/20 = 61\,000 - 30\,500(\text{existing}) = 30\,500(\text{equity acquired from parent})$



Comments

- a The parent's interest in S Ltd changed from 80% (8 000/10 000 shares) up to 30 June 20.25 to 60% (6 000/10 000 shares) thereafter.
- b Note that as control is not lost in this example, there is no need to remeasure the retained investment in the subsidiary to fair value at the date the interest is disposed of. IFRS 10.25(b), therefore, does not apply. It should also be borne in mind that IFRS 10.23 states that changes in a parent's owners' equity in a subsidiary that **do not result in a loss of control** are accounted for as equity transactions (i.e. transactions with owners **in their capacity as owners**).

- c The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the NCI)**:

Fair value of the consideration paid by NCI	(35 000)
Amount by which the non-controlling interests are adjusted (reserves acquired from parent – see below)	30 500
NCI after transaction $((156\,500 - 4\,000\text{GW}) \times 40\%)$	61 000
NCI before transaction $((156\,500 - 4\,000\text{GW}) \times 20\%)$	(30 500)
Amount to be recognised directly in equity	<u>(R4 500)</u>

The approach in terms of IFRS 10.B96 that the difference between the change in the non-controlling interests and the amount paid or received is to be recognised in equity is also clear from J4 below. The entries made by the parent against the investment (R10 000) and the profit on the sale of the shares (R25 000) are reversed, and the principles of IFRS 10.B96 are applied.

- d The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the parent)**:

Fair value of the consideration received by the parent	35 000
Decrease in parent's interest/amount by which the non-controlling interests are adjusted (reserves sold to NCI)	(30 500)
Parent's interest after transaction $((156\,500 - 4\,000\text{GW}) \times 60\%) + 4\,000\text{GW}$	95 500
Parent's interest before transaction $((156\,500 - 4\,000\text{GW} \times 80\%) + 4\,000\text{GW})$	(126 000)
Amount to be recognised directly in equity	<u>R4 500</u>

The amount for the change in ownership recognised in equity can also be calculated as follows **(from the perspective of the parent)**:

Fair value of the consideration received by the parent	35 000
Equity relinquished to NCI	(30 500)
Historical fair value of shares disposed of (excluding goodwill) (comment (f)) $((40\,000\text{ cost} - 4\,000\text{ goodwill}) \times 20/80)$	(9 000)
Attributable post-acquisition equity disposed of:	
Retained earnings $((8\,000 + 6\,000) \times 20/80)$	(3 500)
Replacement reserve $(72\,000 \times 20/80)$	(18 000)
Amount to be recognised directly in equity (in group context)	<u>R4 500</u>

continued

e	Alternatively, the amount can also be calculated as follows:	
	Proceeds on disposal of interest	35 000
	Attributable net assets disposed of (excluding goodwill) ((156 500 – 4 000) × 20%)	(30 500)
	Goodwill relinquished (not realised as control not lost and not transferred as NCI did not share in any goodwill at acquisition) (comment (f))	—
	Amount to be recognised directly in equity (in group context)	<u>R4 500</u>
f	In this example, goodwill was only recognised in respect of the parent as the non-controlling interests were not measured at fair value on the acquisition date. Therefore, the non-controlling interests did not share in any of the goodwill recognised. Furthermore, IFRS 10.BCZ168 indicates that no changes should be made to goodwill in respect of a disposal of interest where control is maintained (i.e. not lost). As this applies to this particular example, goodwill of R4 000 should be maintained in the consolidated financial statements of the parent company until such time that control is relinquished and the full amount remains attributable to the parent. The calculation of the gain on disposal (at the group level) should, therefore, incorporate the fact that goodwill is not transferred to the non-controlling interests. This is done by using the historical fair value of the assets and liabilities obtained with the original business combination (acquisition) and not the purchase price, which includes the goodwill amount. As was explained in paragraph 13.3 above, this work follows the approach that the parent only relinquishes some of the goodwill that was attributable to it, to the non-controlling owners if goodwill was initially also recognised in respect of the non-controlling interests (NCI was measured at fair value at the date of the business combination).	
g	The group's gain on the partial disposal of the interest can also be calculated from (or reconciled to) the parent's entries as recognised in its separate financial statements, as follows:	
	Parent's profit on sale of shares	25 000
	Adjustments to be made at group level:	
	Add back goodwill included in the cost of investment above, not to be transferred within the group (comment (f)) (4 000 × 20/80)	1 000
	Deduct the parent's interest in since-acquisition reserves disposed of (3 500 RE + 18 000 RR)	(21 500)
	Amount to be recognised directly in equity (in group context)	<u>R4 500</u>

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	40 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	9 000
	<u>49 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(45 000)
Goodwill (parent)	<u>R4 000</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Share capital (SCE) Replacement reserve (SCE) Retained earnings (SCE) Goodwill (SFP) (parent only) Investment in S Ltd (SFP) Non-controlling interests (SCE) Main elimination journal entry at acquisition date	10 000 30 000 5 000 4 000	40 000 9 000
J2	Retained earnings (SCE) Replacement reserve (SCE) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of retained earnings and replacement reserve	2 000 18 000	20 000
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit before the change in interest	1 500	1 500
J4	Investment in S Ltd (SFP) (comment (b)) Profit on sale of shares (P/L) Changes in ownership (equity) (SCE) Non-controlling interests (SCE) Pro forma correction of group gain on disposal to separate equity category to give effect to the requirements of IFRS 10.23	10 000 25 000	4 500 30 500
J5	Replacement reserve (SCE) ($72\,000 \times 20/80$) Retained earnings: Transfer from replacement reserve (SCE) Transfer of replacement reserve due to disposal of owners' equity (comment (c))	18 000	18 000
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit after the change in interest	3 000	3 000



Comments

- a The parent accounted for its investment in the subsidiary at cost, and there were no fair value adjustments in the separate financial statements of P Ltd.
- b J4 firstly reverses the entries made by the parent with the sale of some shares (the parent credited the investment with the partial cost of R10 000 and recognised the profit of R25 000). Then the group's adjustments in respect of the change in ownership are recognised in accordance with IFRS 10.23 and B96. The parent's balance for the investment in the subsidiary is effectively cancelled (balance is Rnil) after all the pro forma consolidation journal entries (Investment of R30 000(given) – R40 000(J1) + R10 000(J4) = Rnil).
- c From the analysis and comment (g) above, it is clear that the parent effectively disposed of a portion of its interest in the replacement reserve of S Ltd ($20/80 \times 72\,000 = R18\,000$) (i.e. loss of reserves attached to the shares disposed of). J5 is needed to reflect this loss of a portion of the reserve. It is also clear from the analysis that the closing balance for the replacement reserve should be R54 000 and not R72 000. This transfer to retained earnings will also be made from any other reserve (e.g. revaluation surplus, or mark-to-market reserve) that the subsidiary may have had.
- d J4 reverses the entries made by the parent with the sale of the shares, but note that the actual current tax (capital gains tax) paid by the parent, is not reversed. This payment has indeed been made to the South African Revenue Services, irrespective of the group's adjustments and cannot be reversed. Some experts are of the opinion that this tax expense should, however, be moved to equity as the group's adjustment is made to equity. The journal entry would be to debit the "change in ownership (equity)" and to credit the "income tax expense (P/L)". However, this has not been done in this work as the authors are of the opinion that the tax expense rather relates to the parent's sale of the shares, than to the group's adjustment of its owners' equity interests (between the parent and the non-controlling interests), as equity is already an after-tax amount.

C4 Detailed calculation of allocation of equity

	Total	Attributable to parent	Attributable to NCI
Equity of subsidiary before change represented by:	156 500	126 000	30 500
Other net assets	152 500	122 000	30 500
Goodwill	4 000	4 000	–
Change in ownership represented by:		(30 500)	30 500
Other net assets reallocated		(30 500)	30 500
Goodwill relinquished		N/A	N/A
Equity of subsidiary after change represented by:	156 500	95 500	61 000
Other net assets	152 500	91 500	61 000
Goodwill	4 000	4 000	–

The following example is used to contrast the **measurement of the non-controlling interests at fair value** at the acquisition date to the measurement thereof at their proportionate share of the acquiree’s identifiable net assets (as in the example above).

Example 13.4b	Partial disposal of an interest in a subsidiary with no change in the status as the subsidiary remains a subsidiary (control is not lost) (NCI is measured at fair value at the date of acquisition)
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Assume the same information as in example 13.4a, except that P Ltd elected to measure non-controlling interests at fair value at the date of acquisition. The fair value of the non-controlling interests was R9 900 at the acquisition date (when P Ltd obtained control over S Ltd).

Solution 13.4b

The consolidated statement of profit or loss and other comprehensive income is the same as in part (a) of the example. The rest of the consolidated financial statements are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.25	
ASSETS	
Non-current assets	
Goodwill (parent and NCI)	4 900
Current assets	
Inventory (70 000(P) + 100 000(S))	170 000
Bank (63 150(P) + 60 000(S))	123 150
	293 150
Total assets	R298 050
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	90 000
Retained earnings	84 650
Other components of equity (54 000 + 3 500)	57 500
	232 150
Non-controlling interests	65 900
Total equity	298 050
Total equity and liabilities	R298 050

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.25							
	Share capital	Changes in ownership	Re-tained earnings	Re-placement reserve	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.25	90 000	—	* 38 000	72 000	200 000	! 29 900	229 900
Changes in equity for 20.25							
Total comprehensive income for the year:							
Profit for the year	—	—	28 650	—	28 650	4 500	33 150
Transfer from replacement reserve	—	—	18 000	(18 000)	—	—	—
Disposal of interest	—	3 500	—	—	3 500	31 500	35 000
Balance at 31 Dec 20.25	R90 000	R3 500	R84 650	R54 000	R232 150	R65 900	R298 050

* 30 000(P) + 8 000(S) = 38 000

! 9 900(at) + 2 000(RE) + 18 000(RR) = 29 900

P LTD GROUP NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	
Changes in ownership in subsidiary:	
During the current year, P Ltd sold a 20% interest in S Ltd, an existing subsidiary, without losing control over S Ltd. This resulted in an amount of R3 500 being recognised in equity as presented in the consolidated statement of changes in equity. Details of the transaction between the equity participants are as follows:	
Fair value of the consideration received	35 000
Increase in the non-controlling interests	(31 500)
Adjustment to equity attributable to owners of the parent	R3 500

Calculations

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 80%–60%		NCI
		At	Since	
i At acquisition (1/1/20.21)				
Share capital	10 000	8 000		2 000
Replacement reserve	30 000	24 000		6 000
Retained earnings	5 000	4 000		1 000
	45 000	36 000		9 000
Equity represented by goodwill – Parent and NCI	4 900	4 000		900
Consideration and NCI	49 900	40 000		9 900
ii Since acquisition				
• To beginning of current year:				
Retained earnings (15 000 – 5 000)	10 000		8 000 RE	2 000
Replacement reserve (120 000 – 30 000)	90 000		72 000 RR	18 000
• Current year:				
Profit: 1/1/20.25–30/6/20.25 (15 000 × 6/12)	7 500		6 000 RE	1 500
	157 400		14 000 RE 72 000 RR	31 400
Disposal of 2 000 shares (1) (comment (b))		(9 000) (1 000)	(3 500) RE (18 000) RR	31 500
	157 400			62 900
Profit: 1/7/20.25–31/12/20.25 (15 000 × 6/12)	7 500		4 500 RE	3 000
	R164 900		R15 000 RE	R65 900
			R54 000 RR	

RE = Retained earnings

RR = Replacement reserve

(1) $36\,000 \times 20/80 = 9\,000$ AT

$4\,000 \times 20/80 = 1\,000$ Goodwill (comment (d))

$(8\,000 + 6\,000) \times 20/80 = 3\,500$ RE

$72\,000 \times 20/80 = 18\,000$ RR

NCI: $9\,000 + 1\,000 + 3\,500 + 18\,000 = 31\,500$ (equity acquired from parent)



Comments

- a The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the NCI)**:

Fair value of the consideration paid by NCI	(35 000)
Amount by which the non-controlling interests are adjusted (reserves acquired from parent – see below)	31 500
NCI after transaction $((157\,400 - 4\,900\text{GW}) \times 40\%) + (900 \text{ initial GW of NCI}) + (4\,000 \text{ GW of parent} \times 20/80) \text{ relinquished to NCI})$	62 900
NCI before transaction $((157\,400 - 4\,900\text{GW}) \times 20\%) + (900 \text{ initial GW of NCI})$	(31 400)
Amount to be recognised directly in equity	<u>(R3 500)</u>

Through the parent's disposal of 20% of the interest in the subsidiary (being $20/80 = 25\%$ of the parent's interest), 20% of the net asset value (excluding goodwill) $((157\,400 - 4\,900) \times 20\% = 30\,500)$ was transferred from the parent's interest to the non-controlling interests. Furthermore, the parent relinquished some of its own goodwill $(4\,000 \times 20/80 = 1\,000)$ to the non-controlling owners. This resulted in an increase in the non-controlling interests of R31 500 $(30\,500 + 1\,000)$.

- b The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the parent)**:

Fair value of the consideration received by the parent	35 000
Decrease in parent's interest / amount by which the non-controlling interests are adjusted (reserves sold to NCI)	(31 500)
Parent's interest after transaction $((157\,400 - 4\,900\text{GW}) \times 60\%) + 4\,000\text{GW} - (4\,000 \text{ GW of parent} \times 20/80)$	94 500
Parent's interest before transaction $((156\,500 - 4\,000\text{GW} \times 80\%) + 4\,000\text{GW})$	(126 000)
Amount to be recognised directly in equity	<u>R3 500</u>

The amount for the change in ownership recognised in equity can also be calculated as follows **(from the perspective of the parent)**:

Fair value of the consideration received by the parent	35 000
Equity relinquished to NCI	(31 500)
Historical fair value of shares disposed of (including goodwill) (comment (d)) $(40\,000 \text{ cost} \times 20/80)$	(10 000)
Attributable post-acquisition equity disposed of:	
Retained earnings $((8\,000 + 6\,000) \times 20/80)$	(3 500)
Replacement reserve $(72\,000 \times 20/80)$	(18 000)
Amount to be recognised directly in equity (in group context)	<u>R3 500</u>

- c Alternatively, the amount can also be calculated as follows:

Proceeds on disposal of interest	35 000
Attributable net assets disposed of (excluding goodwill) $((157\,400 - 4\,900) \times 20\%)$	(30 500)
Goodwill relinquished (as NCI also shared in the goodwill) (comment (d)) $(4\,000 \times 20/80)$	(1 000)
Amount to be recognised directly in equity (in group context)	<u>R3 500</u>

continued

d	In this example, goodwill was recognised in respect of the parent and the non-controlling interests (by being measured at fair value on the acquisition date). Therefore, the non-controlling did share in the goodwill recognised. Furthermore, IFRS 10.BCZ168 indicates that no changes should be made to goodwill in respect of a disposal of interest where control is maintained (i.e. not lost). As this is the case in this particular example, goodwill of R4 900 should be maintained in the consolidated financial statements of the parent company until such time that control is relinquished. However, R3 000 (4 000 – 1 000 relinquished) of the goodwill is now attributable to the parent, and R1 900 (900 initial + 1 000 from parent) is now attributable to the non-controlling interests. The calculation of the gain on disposal (at group level) should therefore incorporate the fact that goodwill is indeed transferred to the non-controlling interests. This is done by using the purchase price of the investment, which includes the goodwill number. As was explained in paragraph 13.3 above, this work follows the approach that the parent does relinquish some of the goodwill that was attributable to it, to the non-controlling owners if goodwill was initially also recognised in respect of the non-controlling interests (NCI was measured at fair value at the date of the business combination).								
e	The group's gain on the partial disposal of the interest can also be calculated from (or reconciled to) the parent's entries as recognised in its separate financial statements, as follows: <table><tr><td>Parent's profit on the sale of shares</td><td>25 000</td></tr><tr><td>Adjustments to be made at group level:</td><td></td></tr><tr><td> Deduct parent's interest in since-acquisition reserves disposed of (3 500 RE + 18 000 RR)</td><td>(21 500)</td></tr><tr><td>Amount to be recognised directly in equity (in group context)</td><td><u>R3 500</u></td></tr></table>	Parent's profit on the sale of shares	25 000	Adjustments to be made at group level:		Deduct parent's interest in since-acquisition reserves disposed of (3 500 RE + 18 000 RR)	(21 500)	Amount to be recognised directly in equity (in group context)	<u>R3 500</u>
Parent's profit on the sale of shares	25 000								
Adjustments to be made at group level:									
Deduct parent's interest in since-acquisition reserves disposed of (3 500 RE + 18 000 RR)	(21 500)								
Amount to be recognised directly in equity (in group context)	<u>R3 500</u>								

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	40 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	9 900
	<u>49 900</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(45 000)
Goodwill (parent and NCI)	<u>R4 900</u>

C3 Pro forma consolidation journal entries

The pro forma consolidation journal entries are the same as in example 13.4a, except for those indicated below.

		Dr R	Cr R
J1	Share capital (SCE) Replacement reserve (SCE) Retained earnings (SCE) Goodwill (SFP) (parent and NCI) Investment in S Ltd (SFP) Non-controlling interests (SCE) Main elimination journal entry at acquisition date	10 000 30 000 5 000 4 900	40 000 9 900
J4	Investment in S Ltd (SFP) Profit on sale of shares (P/L) Changes in ownership (equity) (SCE) Non-controlling interests (SCE) Pro forma correction of group gain on disposal to separate equity category to give effect to the requirements of IFRS 10.23	10 000 25 000	3 500 31 500

C4 Detailed calculation of allocation of equity

	Total	Attributable to parent	Attributable to NCI
Equity of subsidiary before change represented by:	157 400	126 000	31 400
Other net assets	152 500	122 000	30 500
Goodwill	4 900	4 000	900
Change in ownership represented by:		(31 500)	31 500
Other net assets reallocated		(30 500)	30 500
Goodwill relinquished (4 000 × 20/80)		(1 000)	1 000
Equity of subsidiary after change represented by:	157 400	94 500	62 900
Other net assets	152 500	91 500	61 000
Goodwill	4 900	3 000	1 900

13.8 Loss of control with partial disposal of a subsidiary, with a simple investment retained

This section of the work deals with a **loss of control**, and IFRS 10.25–26 and B97–B99 should be consulted in this regard.

1 IFRS 10.25 and B98 states that **if a parent loses control** of a subsidiary, it (in the **consolidated** financial statements):

- ☐ derecognises the assets (including any goodwill) and liabilities of the subsidiary at their (consolidated) carrying amounts (after all consolidation adjustments) on the date when control is lost;

- ☐ derecognises the carrying amount of any non-controlling interests in the former subsidiary on the date when control is lost (including any components of other comprehensive income attributable to them);
- ☐ recognises:
 - the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and
 - if the transaction that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution;
- ☐ recognises any investment retained in the former subsidiary at its fair value on the date when control is lost;
- ☐ reclassifies to profit or loss, or transfers directly to retained earnings if required in accordance with other IFRSs, the amounts from other comprehensive income as if the parent had directly disposed of that subsidiary (refer to IFRS 10.B99); and
- ☐ recognises any resulting difference as a gain or loss in **profit or loss** attributable to the parent.



Comments

- a As indicated above, the carrying amounts of goodwill and non-controlling interests are derecognised. This applies irrespective of whether the **non-controlling interests** (which effects the measurement of goodwill) were measured at fair value or at their proportionate share of the acquiree's identifiable net assets at the date of acquisition, in terms of IFRS 3.19.
- b The process listed above (in terms of IFRS 10.B98) can easily be used to calculate the **group's profit or loss** on the loss of control of the subsidiary.

- 2 This treatment reflects that a loss of control is a significant economic event that **changes the nature of the investment** (refer to IFRS 10.BCZ180–183). It also indicates that the loss of control over a subsidiary represents a loss of control over the assets and liabilities of the subsidiary and that a new investment (if any) in the former subsidiary is acquired.

Any investment that is **retained** in the former subsidiary (i.e. after the loss of control) should be measured at its **fair value on the date when control is lost**. Any gain or loss arising from such **remeasurement** should be recognised directly in **profit or loss** of the group. Note that this principle also applies to the loss of significant influence or joint control where the retained interest is a financial asset (IAS 28.22(b)) (refer to IAS 28.BC29 for more information in this regard).

IFRS 10.25(b) further states that, on the loss of control of a subsidiary, any investment retained in the former subsidiary shall be accounted for in accordance with other IFRSs from the date when control is lost (e.g. IFRS 9 **Financial Instruments** or **IAS 28 Investments in Associates and Joint Ventures**). The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with **IFRS 9 Financial Instruments** or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture (to be equity-accounted under IAS 28).

- 3 In its **separate** financial statements, the parent will recognise a gain or loss on the disposal of the shares or will transfer an appropriate amount from the mark-to-market reserve to retained earnings, depending on whether the investment in the subsidiary was measured at cost or in accordance of IFRS 9 (at fair value through other comprehensive income). Refer to paragraph 13.6 of this chapter for more detail in this regard. The entries made in the parent's separate financial statements will be reversed upon consolidation, and the consolidated profit or loss will be accounted for, as indicated above.

IAS 27 and IFRS 10 are not clear on how any **retained investment** should be accounted for after the partial sale in the separate financial statements of the parent. However, this matter is addressed in the IFRIC Update of January 2019. If the retained investment only represents a simple investment (with no control, joint control, or significant influence), it should be accounted for as a financial asset under IFRS 9 and initially be measured at fair value. If the parent had measured the investment in the former subsidiary at **cost**, the remeasurement from the remaining cost to the fair value should be recognised in **profit or loss** (similar to a "day 1" gain – refer to IFRS 9.B5.1.2A(a)). Furthermore, at the date of losing control over the investee, the parent **may elect to subsequently** measure the retained investment at fair value through other comprehensive income (under IFRS 9.4.1.4 and 5.7.5). If the parent had measured the investment in the former subsidiary at **fair value** under IFRS 9, that fair value would merely represent the initial measurement of the retained financial asset.

- 4 Should **control over a subsidiary be lost** during the course of the financial reporting period, the following applies with respect to the **consolidated** statement of financial position and statement of profit or loss and other comprehensive income:

☐ **Consolidated statement of financial position**

The consolidated statement of financial position as at the financial reporting date contains the assets and liabilities of the parent as well as the assets and liabilities of companies which, at the financial reporting date, are in fact, subsidiaries of the parent. Consequently, a subsidiary disposed of in its entirety during the current financial period is **not included at all** in the consolidated statement of financial position at the consolidation date.

☐ **Consolidated statement of profit or loss and other comprehensive income**

The consolidated statement of profit or loss and other comprehensive income contains the income and expenses and other comprehensive income of:

- the parent;
- the subsidiaries that were subsidiaries for the whole term of the year under consideration; and
- the **appropriate portion** of the income and expenses and other comprehensive income of subsidiaries that were subsidiaries only for a part of the year (for the period that the parent controlled the subsidiary) under consideration.

The operating results of subsidiaries acquired during the reporting period are consequently included in the consolidated statement of profit or loss and other comprehensive income as from the date of acquisition, whilst the results of a subsidiary disposed of are **included up to the date of disposal**.

From the group's perspective, the loss of control of a subsidiary is the loss of control over the individual assets and liabilities. Accordingly, the general IFRS requirements should be applied in accounting for the derecognition of the subsidiary's individual assets and liabilities from the group's financial statements. This implies that any gains or losses **previously recognised in other comprehensive income** will be reclassified from other comprehensive income to profit or loss (e.g., the foreign currency translation reserve – refer to chapter 16), and some items will only be **transferred within equity** (e.g., the revaluation surplus on property, plant and equipment and the mark-to-market reserve on equity investments (if so elected) transferred to retained earnings).



Comment

As a starting point for the consolidation, it is important to note that the financial statements of a subsidiary disposed of before the reporting date will **not be combined** (i.e. added together) with those of the parent. The amounts in respect of the post-acquisition reserves of the subsidiary need to be **journalised into** the consolidated statement of profit or loss and other comprehensive income and statement of changes in equity for the period while the subsidiary was controlled by the parent. This approach is clearly evident in journal 4 below.

- 5 **Disclosure of a loss of control should be made in terms of IFRS 12 Disclosure of Interests in Other Entities.** The parent shall disclose information that enables users of the consolidated financial statements to evaluate the consequences of losing control of a subsidiary during the reporting period (IFRS 12.10(b)(iv)). The following information should be disclosed (IFRS 12.19):
 - ☐ the total gain or loss with the loss of control;
 - ☐ the portion of this gain or loss attributable to measuring any investment retained in the former subsidiary at its fair value at the date of the loss; and
 - ☐ the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).
- 6 Given the requirements of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations**, it should be noted that in the period preceding the disposal of a subsidiary, the latter will most probably meet the requirements of IFRS 5 for classification as a non-current asset held for sale in the consolidated financial statements of the parent company. This would entail classifying the assets of the subsidiary as held for sale on the face of the statement of financial position in a single line item, as well as separately classifying and disclosing the liabilities and equity items of the subsidiary directly relating to non-current assets held for sale. The subsidiary held for sale will most probably also qualify as a component of an entity that is a major line of business or a separate geographical segment, and may therefore qualify for separate presentation and disclosure as a discontinued operation in terms of IFRS 5. This aspect is specifically dealt with later at the end of chapter 14 and is not taken into account at this stage for the sake of simplicity.
- 7 The inclusion of the results of a subsidiary disposed of up to the date of disposal ensures that the part of the results of the subsidiary for the current financial period **over which the parent exercised control**, is reflected in the consolidated statement of profit or loss and other comprehensive income. It also ensures that the consolidated retained earnings at the beginning of the financial period correspond to the consolidated retained earnings at the end of the previous year for consistency and comparability purposes. In the execution of the consolidation procedures, the

inclusion of the results of a subsidiary disposed of **to the date of disposal** is achieved by dividing the **gain on disposal of shares in a subsidiary** (under the cost model) as reflected in the separate financial statements of the parent, where applicable, into the component elements thereof, and then incorporating these elements in the consolidated statement of profit or loss and other comprehensive income accordingly. The component elements are the following:

- ☐ the parent's share in the retained earnings **since acquisition** and other reserves of the subsidiary disposed of to the beginning of the current year

plus

- ☐ the parent's share in the subsidiary's profit for the **current year** to the date of disposal

plus

- ☐ the **gain (loss) on disposal** of the interest in the group context (as discussed earlier)

equals

- ☐ the **gain (loss) on disposal** of shares as reflected in the separate records of the **parent** under the cost model.

- 8 The following example illustrates the consolidation of the financial statements of a group where control over a subsidiary was lost during the course of a year.

Example 13.5	Partial disposal of a subsidiary (loss of control) and an investment retained (NCI is measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date)
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The following are the abridged trial balances of P Ltd and S Ltd on 31 December 20.24:

	P Ltd	S Ltd
CREDITS		
Share capital (50 000/6 000 shares)	50 000	6 000
Retained earnings (at 1/1/20.24)	6 000	1 600
Mark-to-market reserve (at 31/12/20.24) ((1 230 – 1 200) × 78,4%) (rounded)	24	–
Deferred tax ((1 230 – 693) × 80% × 27%) (rounded) or (110 + 6)	116	–
Revenue (*)	8 000	2 000
Profit on the sale of shares (P/L)	3 293	–
Remeasurement gain on retained investment (P/L)	507	–
	R67 940	R9 600
DEBITS		
Bank	60 447	8 000
Cost of sales (*)	4 800	1 400
Income tax expense (*)	1 463	200
Investment in S Ltd: 600 shares at the fair value of R2.05 each	1 230	–
	R67 940	R9 600

(*) Accrued/incurred evenly (irrespective of the sale of the shares)

Additional information

- 1 P Ltd purchased 4 500 shares in S Ltd (a 75% interest) on 1 January 20.22 for R5 200, when the retained earnings of the latter amounted to R400.
P Ltd disposed of 3 900 of these shares (a 65% interest) on 30 June 20.24 for R7 800 (also the fair value).
- 2 P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. On the date of the business combination, the carrying amounts of the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3.
- 3 P Ltd accounted for the investment in S Ltd (as a subsidiary) at cost in its separate financial statements.
- 4 After the loss of control, P Ltd classified the investment in S Ltd as a financial asset under IFRS 9 in its individual financial statements. Subsequently, P Ltd recognised fair value adjustments in the mark-to-market reserve (other comprehensive income). Fair value adjustments are recognised monthly. P Ltd elected to present the other comprehensive income **net after tax** in the statement of profit or loss and other comprehensive income (IAS 1.91(a)). The fair value per share of S Ltd on the various dates was as follows:
On 30 June 20.24 R2,00
On 31 December 20.24 R2,05
- 5 The disposal of the shares in the subsidiary did **not** comply with the criteria of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** until the date of disposal.
- 6 The subsidiary does **not** represent a separate major line of business or geographical area of the group.
- 7 A company tax rate of 27% applies and CGT is calculated at 80% thereof.

The **actual** journal entries to recognise the **partial sale** of the share investment in the **separate** financial statements of the **parent** will be:

		Dr R	Cr R
J1	Bank (SFP) (3 900 × R2,00 per share) Investment in S Ltd (SFP) (3 900/4 500 × R5 200(cost)) Profit on the sale of shares (P/L) Recording proceeds and profit on partial disposal of investment	7 800	4 507 3 293
J2	Income tax expense (P/L) (3 293 × 80% × 27%) SARS tax payable/Bank (SFP) Capital gains tax (current tax) payable on disposal of shares	711	711

The **remaining investment** is still recognised at the **cost** of R693 (600/4 500 × R5 200). This investment should now be classified as a financial asset and must initially be measured at fair value (IFRS 9.5.1.1). The **initial** remeasurement to fair value should be recognised in **profit or loss**.

The **subsequent** remeasurements to fair value (from R1 200 to R1 230) at the end of the year are recognised in **other comprehensive income** (mark-to-market reserve) in terms of the company's accounting policy. An after-tax amount of R24 (R30 × 78,4%, or R30 – R6) is already included in the trial balance above.

The **actual** journal entries to recognise the **initial** remeasurement of the share investment in the **individual** financial statements of the **parent** will be:

		Dr R	Cr R
J3	Investment in S Ltd (SFP) ((600 shares × R2,00) – (600/4 500 × R5 200(cost))) Remeasurement gain on retained investment (P/L) Remeasurement gain on retained investment	507	507
J4	Income tax expense (P/L) (507 × 80% × 27%) Deferred tax (SFP) Tax effect of remeasurement to fair value	110	110

The **deferred tax** on the share investment is calculated as follows:

	Carrying amount	Tax base	Temporary difference	Deferred tax
Initial cost	5 200	5 200	0	0
Partial sale	(4 507)	(4 507)	0	0
Remaining cost	693	693	0	0
Remeasurement to fair value	507	0	507	110
Fair value (initial measurement under IFRS 9)	1 200	693	507	110
Subsequent remeasurement (OCI)	30	0	30	6
Fair value at year-end	1 230	693	537	116



Comment

- a In this work (refer to paragraph 4.4), the deferred tax on an investment in shares is measured at the rate applicable to **capital gains**, i.e. 80% of the current tax rate, for example, $80\% \times 27\% = 21,6\%$. The investment in shares is assumed to be of a capital nature for tax purposes. It is regarded as a reflection of the appropriate tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of this investment, i.e. through the sale of the investment (IAS 12.51).

Solution 13.5

The consolidated financial statements of P Ltd and its subsidiaries in respect of the year ended 31 December 20.24 are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.24	
ASSETS	
Non-current assets	
Investment at fair value (1 230(P)) or (600 shares × R2,05)	1 230
Current assets	
Bank (60 447(P))	60 447
Total assets	R61 677
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	50 000
Retained earnings	11 537
Mark-to-market reserve ((1 230 – 1 200) × 78,4%)(P) (rounded)	24
	61 561
Non-controlling interests	–
Total equity	61 561
Liabilities	
Deferred tax ((1 230 – 693) × 80% × 27%(P)) (rounded)	116
Total equity and liabilities	R61 677

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.24	
Revenue (8 000(P) + 1 000(J1))	9 000
Cost of sales (4 800(P) + 700(J1))	(5 500)
Gross profit	3 500
Other income (gain on disposal of interest) (J1)	2 750
Profit before tax	6 250
Income tax expense (1 463(P) + 100(J1))	(1 563)
PROFIT FOR THE YEAR	4 687
Other comprehensive income, net of tax:	
Items that will not be reclassified to profit or loss:	
Mark-to-market reserve (fair value adjustment on investment) ((1 230 – 1 200) × 78,4%)	24
Other comprehensive income for the year, net of tax	24
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R4 711
Profit attributable to:	
Owners of the parent	4 637
Non-controlling interests (50(J1))	50
	R4 687
Total comprehensive income attributable to:	
Owners of the parent (4 637 + 24)	4 661
Non-controlling interests (50(J1))	50
	R4 711

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.24						
	Share capital	Retained earnings	Mark-to-market reserve	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.24	50 000	* 6 900	–	56 900	1 900	58 800
Changes in equity for 20.24						
Total comprehensive income for the year:						
Profit for the year	–	4 637	–	4 637	50	4 687
Other comprehensive income	–	–	24	24	–	24
Loss of control over subsidiary	–	–	–	–	(1 950)	(1 950)
Balance at 31 Dec 20.24	R50 000	R11 537	R24	R61 561	–	R61 561

* 6 000(P) + 900(S) = 6 900

P LTD GROUP NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Loss of control over subsidiary: During the current year, P Ltd sold a 65% interest in S Ltd (parent's controlling 75% interest reduced to a simple investment of 10% in S Ltd) and lost control over S Ltd. This resulted in a total amount of R2 750 being included in the line item of "Other income" in profit or loss. Included in this amount is R367, which relates to the measuring of the retained investment to its fair value. After the sale, P Ltd does not have control, joint control or significant influence over S Ltd and accounts for its remaining investment in S Ltd as a financial asset at fair value through other comprehensive income.

	Comment a Due to the disposal of the interest held in S Ltd by P Ltd, the non-controlling interests are derecognised. This is because S Ltd is no longer a subsidiary of P Ltd (control is relinquished). b IFRS 12.19 requires that an entity shall disclose the gain or loss (gain of R2 750) with the loss of control over a subsidiary. Furthermore, the entity should disclose the portion of that gain or loss attributable to measuring any investment retained in the former subsidiary at its fair value at the date when control is lost (being R367 – see comments below for the calculations). The line item (being other income) in profit or loss in which the gain or loss is recognised (if not presented separately) should also be disclosed.
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Calculations

Although control over the subsidiary was relinquished during the current financial period, it is essential **to analyse** the equity of this subsidiary **up to the date of disposal**. The detail in the analysis of the owners' equity makes it possible to break down the **gain on disposal of the interest in S Ltd** into the three components contained therein, i.e.:

- ☐ the gain in the group context;
- ☐ the profits attributable since the acquisition of the subsidiary to the beginning of the period in which the subsidiary was disposed of; and
- ☐ the attributable profit of the subsidiary for the period in which it was disposed of.



Comment

These three components (together with the reversal of the parent's entries in its separate financial statements) are also clearly evident in journal 1 below.

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 75%–10%		NCI
		At	Since	
i At acquisition (1/1/20.22)				
Share capital	6 000	4 500		1 500
Retained earnings	400	300		100
	6 400	4 800		1 600
Equity represented by goodwill – Parent	400	400		–
Consideration and NCI	6 800	5 200		1 600
ii Since acquisition				
• To beginning of current year: Retained earnings (1 600 – 400)	1 200		900	300
• Current year: Profit: 1/1/20.24–30/6/20.24 (2 000 – 1 400 – 200) × 6/12	200		150	50
Total equity (represented by other net assets of R7 800 and goodwill of R400)	8 200		1 050	1 950
Derecognise assets (including goodwill), liabilities and NCI (IFRS 10.B98)	(8 200)	(4 800) (400)	(1 050)	(1 950)
	–		–	–

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	5 200
Amount of non-controlling interests: IFRS 3.32(a)(ii)	1 600
	6 800
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(6 400)
Goodwill (parent)	R400

C3 Pro forma consolidation journal entries – S Ltd

		Dr R	Cr R
J1	Profit on the sale of shares (P/L)	3 293	
	Remeasurement gain on retained investment (P/L)	507	
	Retained earnings – Beginning of year (SCE)		900
	Revenue (P/L) (comment (d)) (2 000 × 6/12)		1 000
	Cost of sales (P/L) (comment (d)) (1 400 × 6/12)	700	
	Income tax expense (P/L) (comment (d)) (200 × 6/12)	100	
	Non-controlling interests (P/L)	50	
	Gain on disposal of interest (group context) (P/L) (comment (b))		2 750
	Consolidation of subsidiary S Ltd and recognition of disposal of interest at group level		
J2	Non-controlling interests (SCE) (derecognised)	1 950	
	Non-controlling interests (SCE) (opening balance in equity)		1 900
	Non-controlling interests (SCE) (current year's interest in profit)		50
	Accounting for various line items of non-controlling interests in equity for S Ltd (comment (g))		



Comments

a The fair value adjustments to the investment in S Ltd were as follows:	
Fair value of remaining investment at 30 June 20.24 ($600 \times R2,00$)	1 200
Fair value adjustment to end of current year	30
Fair value at end of current year ($600 \times R2,05$)	<u>R1 230</u>
b If a parent loses control, as is the case with S Ltd here, the gain or loss on disposal of the interest would be calculated as follows using IFRS 10.B98:	
Derecognise assets (including goodwill) and liabilities on date control is lost	
(7 800 other net assets + 400 goodwill)	(8 200)
Derecognise non-controlling interests	<u>1 950</u>
Carrying amount of P Ltd's interest in S Ltd lost	(6 250)
Recognise consideration received	7 800
Fair value of investment retained ($600 \text{ shares} \times R2,00$)	1 200
Gain (consolidated) recognised in profit or loss	<u>R2 750</u>
The total gain should effectively be presented as a gain on the disposal of an interest in the subsidiary and a remeasurement gain on remeasuring the retained investment to fair value (IFRS 12.19). These items could be calculated as follows:	
Carrying amount of interest sold ($65/75 \times R6 250$ (above))	(5 417)
Recognise consideration received	<u>7 800</u>
Profit on disposal	<u>R2 383</u>
Carrying amount of interest retained ($10/75 \times R6 250$ (above))	(833)
Fair value of investment retained ($600 \text{ shares} \times R2,00$)	1 200
Remeasurement gain	<u>R367</u>
c By means of the relevant amounts (as contained in the analysis of the ownership interest of S Ltd), the gain on the disposal of the shares in S Ltd can be analysed as follows:	
Proceeds on disposal of interest	7 800
Historical cost of shares disposed of ($5 200 \times 3 900/4 500$)	(4 507)
At-acquisition equity disposed of ($4 800 \times 65/75$)	(4 160)
Goodwill realised (only for the parent company) ($400 \times 65/75$)	<u>(347)</u>
Gain on disposal of interest per separate records of P Ltd	3 293
Attributable post-acquisition retained earnings disposed of ($(900 + 150) \times 65/75$)	<u>(910)</u>
Profit on disposal	2 383
Plus remeasurement of retained investment to fair value	
($1 200 - ((4 800 \times 10/75) + (1 050 \times 10/75) + (400 \times 10/75))$)	
or ($1 200 - ((\text{net asset value of } 7 800 \times 10\%) + (400 \times 10/75))$)	367
Consolidated gain on disposal of the interest	<u>R2 750</u>
Or	
Proceeds on disposal of interest	7 800
Attributable net assets disposed of (net asset value of $R7 800 \times 65\%$)	(5 070)
Goodwill realised (only for the parent company) ($400 \times 65/75$)	<u>(347)</u>
Profit on disposal	2 383
Remeasurement of retained investment to fair value	367
Consolidated gain on disposal of the interest	<u>R2 750</u>

continued

	Care should be taken not to confuse the proceeds of R7 800 with the net asset value of the subsidiary of R7 800 at the date of the loss of control. It is purely a coincidence that the amounts are the same. d In the consolidation, the financial statements of S Ltd are not combined (i.e. added together) with those of P Ltd as S Ltd is not a subsidiary of P Ltd at the end of the reporting period. The amounts in respect of S Ltd are accounted for by means of J1 (i.e. these amounts have to be journalised into the consolidated statement of profit or loss and other comprehensive income and the consolidated statement of changes in equity for the period while S Ltd was a subsidiary). e The investment in S Ltd is, after the loss of control, treated as a simple investment (at fair value through other comprehensive income). Therefore, the investment account should equal the fair value of R1 230 (see comment (a)). The mark-to-market reserve should reflect the fair value gain after the loss of control, being R24 $((1\,230 - 1\,200) \times 78.4\%)$, while the deferred tax balance should be R116 $((1\,230 - 693) \times 80\% \times 27\%)$ as is included in the consolidated statement of financial position. f In this example, S Ltd had no other reserves besides the retained earnings. If S Ltd had, for example, a revaluation or mark-to-market reserve, the cumulative balance of such reserves might be transferred to retained earnings on the loss of control over the subsidiary (refer to IFRS 10.B98(c) and B99). Refer to J2 of Example 13.6 for an illustration of such a transfer with the loss of control over a subsidiary. g All entries in J2 are made against the same ledger account with no net effect. Thus, it may be argued that J2 is not needed. J2 only assists in preparing the various line items for the non-controlling interests in S Ltd in the consolidated statement of changes in equity.
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Alternative pro forma consolidation journal entries for the sale of P Ltd's interest

		Dr R	Cr R
J1	Investment in S Ltd (SFP) Retained earnings – Beginning of year (SCE) Accounting for retained earnings at the beginning of the year	900	900
J2	Investment in S Ltd (SFP) Revenue (P/L) $(2\,000 \times 6/12)$ Cost of sales (P/L) $(1\,400 \times 6/12)$ Income tax expense (P/L) $(200 \times 6/12)$ Non-controlling interests (P/L) Accounting for profit of subsidiary for the year	150 700 100 50	1 000
J3	Profit on the sale of shares (P/L) Remeasurement gain on retained investment (P/L) Investment in S Ltd (SFP) Reversal of parent's entries for profit on sale of shares and remeasurement of retained investment	3 293 507	3 800
J4	Investment in S Ltd (SFP) Gain on disposal of interest (group context) (P/L) Recognition of gain at group level	2 383	2 383
J5	Investment in S Ltd (SFP) Gain on disposal of interest (remeasurement of retained investment to fair value) (P/L) Recognition of gain at group level from remeasurement of retained investment to fair value	367	367

13.9 Partial disposal of an interest in a subsidiary, whereby it becomes an associate

This section of the work is similar to the section above and also deals with a loss of control over a subsidiary. The requirements of IFRS 10.25–26 and B97–B99 are also applicable. The section above addressed the scenario where control was lost, with a simple investment retained. This section deals with the scenario where control over the subsidiary is lost, but an interest is retained whereby significant influence is exercised.

Therefore, the subsidiary now becomes an associate (or joint venture). In this scenario, specific attention should be placed on the following consolidation procedures:

- ☐ in accounting for the loss of control over the subsidiary, any investment retained in the former subsidiary should be recognised at its fair value on the date when control is lost;
- ☐ this implies that a remeasurement gain or loss should be recognised as part of the profit or loss with the disposal of the interest in the subsidiary;
- ☐ after control is lost, the investment in the associate (or joint venture) should be accounted for under the equity method in terms of IAS 28.

Example 13.6	Partial disposal of an interest in a subsidiary resulting in a change in status as the subsidiary becomes an associate (a loss of control by the parent occurs) (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)
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The following represents the condensed financial statements of P Ltd (with some subsidiaries already consolidated) and A Ltd (that should still be accounted for in the consolidated financial statements) at 31 December 20.27:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd and subsidiaries (consolidated)	A Ltd
ASSETS		
Property, plant and equipment	500 000	70 000
Investment in A Ltd – 40 000 shares at cost	51 000	–
Equity investments at fair value through other comprehensive income	–	25 421
Inventory	369 000	109 200
Total assets	R920 000	R204 621
EQUITY AND LIABILITIES		
Share capital (400 000/100 000 shares)	400 000	100 000
Retained earnings	420 000	99 200
Mark-to-market reserve	–	4 250
Non-controlling interests		–
(60 000 opening balance + 40 000 current year)	100 000	
Deferred tax	–	1 171
Total equity and liabilities	R920 000	R204 621

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd and sub- sidiaries (consoli- dated)	A Ltd
Revenue	671 000	111 200
Cost of sales	(210 000)	(36 000)
Gross profit	461 000	75 200
Other income (gain on disposal of interest)	35 000	–
Other income (dividend received)	10 000	–
Profit before tax	506 000	75 200
Income tax expense	(146 000)	(24 000)
PROFIT FOR THE YEAR	360 000	51 200
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Mark-to-market reserve (fair value adjustment on investment)	–	3 253
Income tax relating to items that will not be reclassified	–	(703)
Other comprehensive income for the year, net of tax	–	2 550
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R360 000	R53 750
Profit attributable to:		
Owners of the parent	320 000	51 200
Non-controlling interests	40 000	–
	R360 000	R51 200
Total comprehensive income attributable to:		
Owners of the parent	320 000	53 750
Non-controlling interests	40 000	–
	R360 000	R53 750

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27			
	Mark-to-market reserve A Ltd	Retained earnings	
		P Ltd and sub-sidiaries (consolidated) – parent	A Ltd
Balance at 1 January 20.27	1 700	150 000	73 000
Change in equity for 20.27			
Total comprehensive income for the year:			
Profit for the year	–	320 000	51 200
Other comprehensive income	2 550	–	–
Dividend paid: 31/12/20.27	–	(50 000)	(25 000)
Balance at 31 December 20.27	R4 250	R420 000	R99 200

Additional information

- 1 P Ltd acquired 80% of the issued share capital of A Ltd on 1 January 20.23 for R102 000, when the retained earnings of A Ltd amounted to R25 000.
- 2 P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. On the date of the business combination, the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3.
- 3 On 31 March 20.27, P Ltd disposed of 40 000 shares in A Ltd for R86 000. P Ltd has exercised significant influence over the financial and operating policy decisions of A Ltd since that date. The fair value of the remaining investment by P Ltd in A Ltd was R80 000 at the date of disposal of the interest.
- 4 P Ltd accounted for the investment in A Ltd at cost in its separate financial statements (in terms of IAS 27.10 and IAS 28.44). P Ltd's accounting policy is to account for the retained investment (after the partial sale) still at its partial cost.
- 5 The disposal of the interest in the subsidiary did **not** comply with the criteria of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** until the date of disposal thereof.
- 6 The subsidiary does **not** represent a separate major line of business or geographical area of the group.
- 7 A Ltd's profit and tax for 20.27 accrued evenly.
- 8 The fair value gain on the equity investments of A Ltd, subsequently measured at fair value through other comprehensive income, only relates to the period after 1 April 20.27.
- 9 Any amount in the mark-to-market reserve would be transferred to retained earnings with the disposal of the underlying investment.
- 10 The company tax rate is 27% and CGT is calculated at 80% thereof.

	Comments	
	a The separate financial statements of P Ltd already include the gain on the partial disposal of its investment in A Ltd. The gain was calculated as follows:	
	Proceeds	86 000
	Cost price of portion sold (40 000/80 000 shares × R102 000)	(51 000)
	Gain on disposal	<u>R35 000</u>
	b The separate financial statements of P Ltd also already include the tax payable on this gain of R7 560 (35 000 × 80% × 27%).	

Solution 13.6

The consolidated financial statements, incorporating the results of A Ltd (as a subsidiary before the partial sale and in accordance with the equity method thereafter), are prepared as follows.

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P and other subsidiaries)	500 000
Investment in associate (51 000(remaining cost) + 29 000(J1) + 16 380(J4) – 10 000(J5)) or (80 000(fair value of retained investment after loss of control) + 6 380(since))	86 380
	<u>586 380</u>
Current assets	
Inventory (P and other subsidiaries)	369 000
Total assets	<u>R955 380</u>
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	400 000
Retained earnings	454 360
Mark-to-market reserve	1 020
	<u>855 380</u>
Non-controlling interests (in respect of other subsidiaries)	100 000
Total equity and liabilities	<u>R955 380</u>

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (671 000(P) + 27 800(A)(J1))	698 800
Cost of sales (210 000(P) + 9 000(A)(J1))	(219 000)
Gross profit (461 000(P) + 18 800(A))	479 800
Other income (gain on disposal of interest)	14 000
Share of profit of associate (J4)	15 360
Profit before tax	509 160
Income tax expense (146 000(P) + 6 000(A)(J1))	(152 000)
PROFIT FOR THE YEAR	357 160
Other comprehensive income:	
Items that will not be reclassified to profit or loss:	
Share of other comprehensive income of associates (comment (a))	1 020
Other comprehensive income for the year, net of tax	1 020
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R358 180
Profit attributable to:	
Owners of the parent (balancing)	314 600
Non-controlling interests (40 000(other) + 2 560(A)(J1))	42 560
	R357 160
Total comprehensive income attributable to:	
Owners of the parent (314 600 profit + 1 020 OCI)	315 620
Non-controlling interests (40 000(other) + 2 560(A)(J1))	42 560
	R358 180

P LTD GROUP
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.27

	Share capital	Retained earnings	Mark-to-market reserve	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.27	400 000	* 188 400	1 360	589 760	! 94 940	684 700
Changes in equity for 20.27						
Dividends	–	(50 000)	–	(50 000)	–	(50 000)
Total comprehensive income for the year:						
Profit for the year	–	314 600	–	314 600	42 560	357 160
Other comprehensive income	–	–	1 020	1 020	–	1 020
Transfer with disposal of interest in A Ltd		1 360	(1 360)			
Disposal of interest in A Ltd and derecognition of non-controlling interests ((J3) and comment (b))	–	–	–	–	(37 500)	(37 500)
Balance at 31 Dec 20.27	R400 000	R454 360	R1 020	R855 380	R100 000	R955 380

* 150 000(P) + 38 400(J1) = 188 400

! Other: 100 000 end – 40 000 current year = 60 000 opening balance for other subsidiaries, plus
A Ltd: 25 000 + 9 600 + 340 = 94 940

P LTD GROUP
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Loss of control over subsidiary:

During the current year, P Ltd sold a 40% interest in S Ltd (half of its 80% interest) and lost control over S Ltd. This resulted in a total amount of R14 000 being included in the line item of “other income” in profit or loss. Included in this amount is R4 000, which relates to measuring the retained investment to its fair value. After the sale, P Ltd has significant influence over S Ltd and accounts for its remaining interest in the associate by applying the equity method.



Comments

- a In terms of the **Guidance on implementing IAS 1 Presentation of Financial Statements**, the share of other comprehensive income of associates is the amount attributable to the parent (i.e. the after tax and non-controlling interests in the associate).
- b Upon the loss of control by P Ltd, A Ltd is no longer a subsidiary of the parent P Ltd and non-controlling interests to the amount of R37 500 are derecognised from the consolidated financial statements of P Ltd. This results in a final amount of R100 000 in respect of the non-controlling interests being recognised in the consolidated financial statements of P Ltd, which relates to the **other** subsidiaries of P Ltd.
- c IFRS 12.19 requires that an entity shall disclose the gain or loss (gain of R14 000) with the loss of control over a subsidiary. Furthermore, the entity should disclose the portion of that gain or loss attributable to measuring any investment retained in the former subsidiary at its fair value (being R4 000) at the date when control is lost. The line item (being other income) in profit or loss in which the gain or loss is recognised (if not presented separately) should also be disclosed.

Calculations

C1.1 Analysis of the owners' equity of A Ltd – as subsidiary

	Total	P Ltd 80%		NCI
		At	Since	
i At acquisition				
Share capital	100 000	80 000		20 000
Retained earnings	25 000	20 000		5 000
	125 000	100 000		25 000
Equity represented by goodwill – Parent	2 000	2 000		–
Consideration and NCI	127 000	102 000		25 000
ii Since acquisition				
• To beginning of current year:				
Retained earnings (73 000 – 25 000)	48 000		38 400 RE	9 600
Mark-to-market reserve	1 700		1 360 MtM	340
• Current year:				
Profit: 1/1/20.27–31/3/20.27 (51 200 × 3/12)	12 800		10 240 RE	2 560
	189 500		48 640 RE 1 360 MtM	37 500
Loss of control over subsidiary:				
Derecognise assets (including goodwill), liabilities and NCI (IFRS 10.B98)	(189 500)	(102 000)	50 000 (50 000)	(37 500)
Transfer of mark-to-market reserve (IFRS 10.B99) (J2)			(1 360) MtM 1 360 RE	
	–	–	–	–

RE = Retained earnings; MtM = Mark-to-market reserve

C1.2 Analysis of the owners' equity of A Ltd – as associate

	Total	P Ltd 40%		NCI
		At	Since	
i At acquisition				
Recognise remaining interest at fair value	200 000	80 000		n/a
ii Since acquisition				
• Current year:				
Profit: 1/4/20.27–31/12/20.27 (51 200 × 9/12)	38 400		15 360 RE	n/a
Mark-to-market reserve	2 550		1 020 MtM	n/a
Dividend	(25 000)		(10 000) RE	n/a
	R215 950		R5 360 RE	n/a
			R1 020 MtM	

RE = Retained earnings; MtM = Mark-to-market reserve

C2 Proof of calculation of goodwill of A Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	102 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	25 000
	127 000
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(125 000)
Goodwill (parent)	R2 000

C3 Pro forma consolidation journal entries

J1		Dr R	Cr R
	Investment in A Ltd (SFP) (80 000 fair value – R51 000 remaining cost in separate financial statements of P Ltd)	29 000	
	Gain on disposal of interest (P) (P/L)	35 000	
	Retained earnings – Beginning of year (SCE)		38 400
	Mark-to-market reserve – Beginning of year (SCE)		1 360
	Revenue (P/L) (111 200 × 3/12) (comment (a))		27 800
	Cost of sales (P/L) (36 000 × 3/12) (comment (a))	9 000	
	Income tax expense (P/L) (24 000 × 3/12) (comment (a))	6 000	
	Non-controlling interests (P/L) (first 3 months) (comment (a))	2 560	
	Gain on disposal of interest (group context) (P/L)		10 000
	Gain on disposal of interest (group context) (P/L) (Remeasurement gain) (IFRS 10.25)		4 000
	Consolidation of subsidiary for first three months and recognition of disposal of interest		

continued

Changes in ownership of subsidiaries through buying or selling shares

		Dr R	Cr R
J2	Mark-to-market reserve (SCE) (comment (c)) Retained earnings (SCE) Transfer of mark-to-market reserve to retained earnings on loss of control over subsidiary in terms of IFRS 10.B99	1 360	1 360
J3	Non-controlling interests (SCE) (derecognised) Non-controlling interests (SCE) (opening balance in equity) (25 000 at + 9 600 RE + 340 MtM) Non-controlling interests (SCE) (current year's interests in profit) Accounting for various line items of non-controlling interests in equity for A Ltd (comment (j))	37 500	34 940 2 560
J4	Investment in A Ltd (as associate) (SFP) Share of profit of associate (P/L) Share of other comprehensive income of associate (MtM) (OCI) Accounting for P Ltd's share of equity of associate for current year (last nine months)	16 380	15 360 1 020
J5	Other income (dividend received from A Ltd as in P Ltd) (P/L) Investment in A Ltd (as associate) (SFP) Elimination of dividend received from associate – IAS 28.10	10 000	10 000



Comments

- a Note that A Ltd was only a subsidiary of P Ltd for the **first three months** of the current year. Since A Ltd was not a subsidiary of P Ltd at the reporting date, A Ltd's individual financial statements will **not be combined** with those of the parent (P Ltd) as a starting point for consolidation. This means that the results for A Ltd (for the period that it was a subsidiary of P Ltd) would have to be **journalised into the consolidation**, as is seen in the pro forma consolidation journal entry above.

- b P Ltd disposed of 40 000 shares in A Ltd and **lost control** over A Ltd. The gain or loss on the disposal of the interest would be calculated as follows using IFRS 10.B98:

Derecognise assets (including goodwill) and liabilities on date control is lost (187 500 other net assets + 2 000 goodwill) (IFRS 10.B98(a))	(189 500)
Derecognise non-controlling interests (IFRS 10.B98(a))	37 500
Net asset value (attributable to parent) derecognised	(152 000)
Fair value of consideration received recognised (i.e. cash received) (IFRS 10.B98(b))	86 000
Recognise fair value of investment in former subsidiary retained (IFRS 10.B98(b))	80 000

Net gain on disposal of interest (group context)

(IFRS 10.B98(d)) attributable to the owners of the parent

R14 000

The total gain should effectively be presented as a gain on the disposal of an interest in the subsidiary and a remeasurement gain on remeasuring the retained investment to fair value (IFRS 12.19). These items could be calculated as follows:

Carrying amount of interest sold ($40/80 \times R152\ 000$ (above))	(76 000)
Recognise consideration received	86 000
Profit on disposal	R10 000
Carrying amount of interest retained ($40/80 \times R152\ 000$ (above))	(76 000)
Fair value of investment retained (given)	80 000
Remeasurement gain	R4 000

The amount of R14 000 comprises R4 000 in respect of the fair value remeasurement of the retained interest (refer to (d) below), plus R10 000 arising from the R86 000 received for equity of R76 000 that was disposed of (refer to (e) below). These two amounts (R4 000 and R10 000) were presented separately in J1 for illustration purposes. Note that these amounts should be disclosed in terms of IFRS 12.19.

- c With the loss of control over a subsidiary, any amount previously recognised in other comprehensive income, should be reclassified to profit or loss, or transferred directly to retained earnings if required in accordance with other IFRSs (refer to IFRS 10.B98(c) and B99).
- d Remeasurement of investment retained in terms of IFRS 10.25(b):
- | | |
|---|----------|
| Fair value of retained 40% investment in former subsidiary (given) (IFRS 10.25(b)) | 80 000 |
| Carrying amount of retained 40% investment in former subsidiary (($102\ 000 \times 40/80$) + ($50\ 000 \times 40/80$)(analysis)) or ($152\ 000$ (comment (b)) $\times 40/80$) | (76 000) |
| Remeasurement (gain) to be recognised in profit or loss (BCZ182) (refer to J1) | R4 000 |

continued

e	By means of the relevant amounts (as contained in the analysis of the ownership interest of A Ltd), the gain on disposal of shares in A Ltd can be analysed as follows:	
	Proceeds on disposal of interest	86 000
	Historical cost of shares disposed of ($102\,000 \times 40/80$)	(51 000)
	At-acquisition equity disposed of ($100\,000 \times 40/80$)	(50 000)
	Goodwill realised ($2\,000 \times 40/80$)	(1 000)
	Gain on disposal of interest per separate records of P Ltd	35 000
	Attributable post-acquisition reserves disposed of ($(48\,640\text{ RE} \times 40/80) + (1\,360\text{ MtM} \times 40/80)$)	(25 000)
	Gain from equity relinquished	10 000
	Remeasurement of investment retained (refer to (d) above)	4 000
	Total consolidated gain on disposal of the interest	<u>R14 000</u>
	The gain of R10 000 from the equity relinquished to NCI can also be calculated as follows:	
	Proceeds on disposal of interest	86 000
	Attributable net assets disposed of (net asset value of $R187\,500 \times 40\%$)	(75 000)
	Goodwill realised (only for the parent company) ($2\,000 \times 40/80$)	(1 000)
	Consolidated gain on disposal of interest	<u>R10 000</u>
	It is important to note that only the goodwill relating to the parent company (i.e. R2 000) is realised in respect of A Ltd. The goodwill relating to the non-controlling interests, if any (none in this example), is not realised in the consolidated financial statements of P Ltd, as this amount already relates to the non-controlling interests and should therefore not be transferred to it again.	
f	To obtain continuity between the amounts of the current and previous periods' consolidated statements of profit or loss and other comprehensive income, the gain of R35 000 (per the separate financial statements of the parent) is included in the current period's consolidated statement of profit or loss and other comprehensive income, and the consolidated statement of changes in equity, as follows:	
	Included in opening consolidated retained earnings at the beginning of the period	38 400
	Included in opening consolidated mark-to-market reserve at the beginning of the period	1 360
	Included in profit for the current period (*) as various line items	10 240
		<u>50 000</u>
	Group's net gain in the consolidated statement of profit or loss and other comprehensive income (see comment (b) above)	14 000
	Adjustment of carrying amount of the investment in associate to fair value (see comment (h) below).	(29 000)
	Gain on disposal of interest per separate records of P Ltd	<u>R35 000</u>
	This approach is also evident from J1 above, where the investment in A Ltd is increased with R29 000 (fair value of R80 000 less cost price of R51 000 still contained in the separate financial statements of P Ltd), the amount of profit per P Ltd is reversed and replaced by the parent's portion of the retained earnings and mark-to-market reserve at the beginning of the period, the various line items in profit or loss and the group's profit on the loss of control over the subsidiary.	

continued

	g The R10 240(*) is taken up in the consolidated statement of profit or loss and other comprehensive income by adding R12 800 to the profit of the group, and by adding (thereafter) R2 560 to the non-controlling interests. h The calculation of the group's profit or loss on the loss of control over a subsidiary includes the measurement of the investment in the former subsidiary retained, at fair value (IFRS 10.25(b)). In this example, the carrying amount of the investment in A Ltd, after the sale of the 40 000 shares, is reflected in P Ltd as R51 000 (remember that the financial statements of P Ltd are the starting point for consolidation – IFRS 10.B86(a)). The fair value of the investment retained is R80 000. Therefore, an adjustment of R29 000 (80 000 – 51 000) is needed to correctly account for the investment at fair value on the date of the disposal of the interest. In contrast to example 13.5 above, this adjustment was not needed as the parent had already remeasured the retained investment to its fair value in its separate financial statements. A comparison table of the pro forma consolidation journal entries for example 13.5 (investment retained is a simple investment measured at fair value) and example 13.6 (investment retained is an associate that is still measured at cost), is given below. i The question arises whether any deferred tax adjustment is needed on the above-mentioned remeasurement gain. Note that P Ltd already accounted for the actual tax expense from the sale of the shares in its separate financial statements. Some are of the opinion that this remeasurement changes the temporary differences on the investment and that deferred tax should then be recognised ($4\,000 \times 80\% \times 27\% = 896$). However, this remeasurement is in respect of P Ltd's equity interest retained in the net assets of A Ltd. Equity is by definition (in terms of the Conceptual Framework) always an after-tax amount. The fair value of the investment retained now becomes the initial investment in an associate. In terms of the equity method, only the investor's share of the net assets of the investee is added to the investment (net assets would be the amount after tax). Similar to the approach that no deferred tax is recognised for changes in the investment in an associate for accounting for the investor's share of the profit (after tax) of the associate, no deferred tax is recognised in respect of this remeasurement gain in this work. j All entries in J3 are made against the same ledger account with no net effect. Thus, it may be argued that J3 is not needed. J3 only assists in preparing the various line items for the non-controlling interests in A Ltd in the consolidated statement of changes in equity.
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Comparison table for loss of control:

LOSS OF CONTROL: PARENT'S SEPARATE FINANCIAL STATEMENTS AND CONSOLIDATION	
Subsidiary becomes IFRS 9 <u>investment</u>	Subsidiary becomes <u>associate</u>
Parent's separate financial statements: □ Parent elected to measure investment in subsidiary at cost (IAS 27). □ Parent sold part of its share investment, and remainder of investment (no control, significant influence or joint control) must then be measured at fair value on initial recognition (IFRS 9.5.1.1).	Parent's separate financial statements: □ Parent elected to measure investment in subsidiary at cost (IAS 27). □ Parent elected to measure investment in associate at cost (IAS 27) (i.e. what remains of the initial cost after the partial sale; no requirement to remeasure to fair value).

continued

LOSS OF CONTROL: PARENT'S SEPARATE FINANCIAL STATEMENTS AND CONSOLIDATION	
Subsidiary becomes IFRS 9 <u>investment</u>	Subsidiary becomes <u>associate</u>
Sale transaction (example 13.5): Dr Bank R7 800 Cr Investment R4 507 Cr Profit on sale (P/L) # R3 293	Sale transaction (example 13.6): Dr Bank R86 000 Cr Investment R51 000 Cr Profit on sale (P/L) # R35 000
Remeasurement of retained investment to fair value: Dr Investment R507 Cr Remeasurement (P/L) # R507	No remeasurement of retained investment to fair value.
Consolidated financial statements: ☐ Retained investment to be remeasured to fair value for the purpose of the group (IFRS 10.B98). The "investment" in parent's separate financial statements is already at the fair value of R1 200 coming into the consolidation (parent plus subsidiary), and no pro forma journal entry is needed against the investment account. ☐ The parent's "profit" and "remeasurement" (as indicated by #) must be replaced by the group's profit (in terms of IFRS 10.B98) and are eliminated.	Consolidated financial statements: ☐ Retained investment to be remeasured to fair value for the purpose of the group (IFRS 10.B98). The "investment" in parent's separate financial statements is still at "remaining cost" coming into the consolidation (parent plus subsidiary), and a pro forma journal is needed to adjust the remaining cost of R51 000 to the fair value of R80 000. ☐ The parent's "profit" (as indicated by #) must be replaced by the group's profit (in terms of IFRS 10.B98) and is eliminated.
Pro forma journals: Dr Profit on sale (P/L) # R3 293 Dr Remeasurement (P/L) # R507 Dr Investment (SFP) n/a Cr Group's profit (P/L) R2 750 <i>And all the other line items...</i>	Pro forma journals: Dr Profit on sale (P/L) # R35 000 Dr Remeasurement (P/L) n/a Dr Investment (SFP) R29 000 Cr Group's profit (P/L) R14 000 <i>And all the other line items...</i>

13.10 Loss of control and intragroup sale of assets

The consolidation adjustments in respect of the intragroup sale of assets were discussed in chapter 5 of this work. More advanced intragroup transactions are discussed in chapter 17. It was emphasised (in chapter 5) that all unrealised intragroup profits should be eliminated in full until the asset is sold to parties outside the group. Furthermore, it was indicated that the unrealised intragroup profit on depreciable assets also realises through the process of depreciation/amortisation while the asset is being used. Should the partially-owned subsidiary sell assets to another entity in the group, the relevant portion of the unrealised gain should be allocated to the non-controlling interests in the subsidiary. When the unrealised gain is again realised, the relevant portion is once again allocated to the non-controlling interests in the subsidiary.

On the loss of control over a subsidiary, the parent-subsidiary relationship ceases to exist. The parent no longer controls the subsidiary's individual assets and liabilities. Therefore, the group derecognises all the individual assets, liabilities and equity related to that subsidiary. It follows that the underlying assets and liabilities of the subsidiary

are effectively sold to parties outside the group. When a parent loses control over a subsidiary, any unrealised intragroup profit is regarded as being realised from the group's perspective, and it is recognised in full (irrespective of whether the parent retains an investment in the former subsidiary – this approach is similar to realising the amounts previously recognised in other comprehensive income in full with the loss of control over a subsidiary). All unrealised intragroup profits will thus be realised with a loss of control over a subsidiary that is regarded as a business (as defined) (IFRS 10.B99A).

Example 13.7**Loss of control over a subsidiary with previous intragroup profits on the sale of depreciable assets**

The following represents the condensed financial statements of P Ltd (with some subsidiaries already consolidated) and S Ltd (that should still be accounted for in the consolidated financial statements) at 31 December 20.27:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd and subsidiaries (consolidated)	S Ltd
ASSETS		
Property, plant and equipment	600 000	70 000
Patents	–	60 000
Investment in S Ltd at cost	–	–
Bank	419 042	109 200
Total assets	R1 019 042	R239 200
EQUITY AND LIABILITIES		
Share capital (400 000/100 000 shares)	400 000	100 000
Retained earnings	489 042	119 200
Non-controlling interests (60 000 opening balance + 40 000 current year)	100 000	–
Total liabilities	30 000	20 000
Total equity and liabilities	R1 019 042	R239 200

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd and subsidiaries (consolidated)	S Ltd
Revenue	671 000	111 200
Cost of sales	(210 000)	(36 000)
Gross profit	461 000	75 200
Other income (gain on disposal of interest)	118 000	–
Profit before tax	579 000	75 200
Income tax expense	(149 958)	(24 000)
PROFIT FOR THE YEAR	429 042	51 200
Other comprehensive income	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R429 042	R51 200
Profit and total comprehensive income attributable to:		
Owners of the parent	389 042	51 200
Non-controlling interests	40 000	–
	R429 042	R51 200

EXTRACT FROM STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd and subsidiaries (consolidated)	S Ltd
Balance at 1 January 20.27	150 000	93 000
Change in equity for 20.27		
Total comprehensive income for the year:		
Profit for the year	389 042	51 200
Other comprehensive income	–	–
Dividend paid: 31/12/20.27	(50 000)	(25 000)
Balance at 31 December 20.27	R489 042	R119 200

Additional information

- 1 P Ltd acquired 80% of the issued share capital of S Ltd on 1 January 20.23 for R102 000, when the retained earnings of S Ltd amounted to R25 000.
- 2 P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date. On the date of the business combination, carrying amounts of the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3.

- 3 On 1 January 20.26, **S Ltd** sold an item of **plant** to P Ltd at a profit of R10 000. The remaining useful life of the plant at that date was five years with no residual value. The plant is depreciated on the straight-line basis.
- 4 On 1 January 20.26, **P Ltd** sold a **patent** to S Ltd at a profit of R9 300. The patent is amortised evenly over three years.
- 5 On 31 March 20.27, P Ltd disposed of all its shares in S Ltd for R220 000.
- 6 P Ltd accounted for the investment in S Ltd at cost in its separate financial statements.
- 7 The disposal of the interest in the subsidiary did **not** comply with the criteria of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** until the date of disposal thereof.
- 8 The subsidiary does **not** represent a separate major line of business or geographical area of the group.
- 9 S Ltd's profit and tax for 20.27 accrued/were incurred evenly.
- 10 The company tax rate is 27% and CGT is calculated at 80% thereof.

	Comments	
	a The separate financial statements of P Ltd already include the gain on the disposal of its investment in S Ltd. The gain was calculated as follows:	
	Proceeds	220 000
	Cost price	(102 000)
	Gain on disposal	<u>R118 000</u>
b The separate financial statements of P Ltd also already include the tax payable on this gain of R25 488 (118 000 × 80% × 27%).		
c This example assumes that adjustments made to the depreciation and amortisation in respect of the intragroup profit from the plant and patent sold between the two companies in the same group will affect the cost of sales line item as these costs form part of the production cost of inventory. Neither company had inventory on hand at the reporting date. Therefore, the full adjustment is made to the cost of sales (nothing to inventory) as all the inventory produced has already been sold.		

Solution 13.7

The consolidated financial statements, incorporating the results of S Ltd (as a subsidiary before the sale), are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P and other subsidiaries)	600 000
	600 000
Current assets	
Bank (P and other subsidiaries)	419 042
Total assets	R1 019 042
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	400 000
Retained earnings	489 042
	889 042
Non-controlling interests (in respect of other subsidiaries)	100 000
Total equity	989 042
Liabilities	
Total liabilities (P and other subsidiaries)	30 000
Total equity and liabilities	R1 019 042

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (671 000(P) + 27 800(S)(J1))	698 800
Cost of sales (210 000(P) + 8 500(S)(J1) - 775(P)(J3))	(217 725)
Gross profit	481 075
Other income (gain on disposal of interest) (60 860(J1) + 5 425(J3))	66 285
Profit before tax	547 360
Income tax expense (149 958(P) + 6 135(S)(J1) + 2 025(S)(J1) + 209(P)(J3) + 1 465(J3))	(159 792)
PROFIT FOR THE YEAR	387 568
Other comprehensive income	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R387 568
Profit and total comprehensive income attributable to:	
Owners of the parent (balancing)	343 840
Non-controlling interests (40 000(other) + 2 633(S)(J1) + 1 095(S)(J1))	43 728
	R387 568

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27					
	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.27	400 000	* 195 202	595 202	! 97 432	692 634
Changes in equity for 20.27					
Dividends	–	(50 000)	(50 000)	–	(50 000)
Total comprehensive income for the year:					
Profit for the year	–	343 840	343 840	43 728	387 568
Disposal of interest in S Ltd and derecognition of non-controlling interests (J2)	–	–	–	(41 160)	(41 160)
Balance at 31 Dec 20.27	R400 000	R489 042	R889 042	R100 000	R989 042

* 150 000(P) + 49 728(J1) – 4 526(J3) = 195 202

! Other: 60 000 opening balance plus S Ltd: 25 000 + 12 432 = 97 432

P LTD GROUP NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Loss of control over subsidiary: During the current year, P Ltd sold its entire 80% interest in S Ltd and lost control over S Ltd. This resulted in a total amount of R66 285 being included in the line item of “other income” in profit or loss. This amount does not include any amount that relates to the measuring of the retained investment to its fair value. The loss of control over S Ltd resulted in previously unrealised gains on the disposal of a plant (by S Ltd to P Ltd) to an after-tax amount of R4 380 (R7 500 before tax and before non-controlling interests) and a patent (by P Ltd to S Ltd) to an after-tax amount of R3 960 (R5 425 before tax) being realised and attributable to the parent.

Calculations

C1 Analysis of the owners' equity of S Ltd – as subsidiary

	Total	P Ltd 80%		NCI
		At	Since	
i At acquisition				
Share capital	100 000	80 000		20 000
Retained earnings	25 000	20 000		5 000
	125 000	100 000		25 000
Equity represented by goodwill – Parent	2 000	2 000		–
Consideration and NCI	127 000	102 000		25 000
ii Since acquisition				
• To beginning of current year: Retained earnings (93 000 – 25 000 – ((10 000 – 2 000) × 73%)) (C5), comment (b))	62 160		49 728 RE	12 432
• Current year: Profit: 1/1/20.27–31/3/20.27 ((51 200 × 3/12) + 500 – 135) (C5), (comment (b))	13 165		10 532 RE	2 633
	202 325		60 260 RE	40 065
Loss of control over subsidiary: Derecognise assets (including goodwill), liabilities and NCI (IFRS 10.B98)	(202 325)	(102 000)	(60 260)	(40 065)
	–	–	–	–

RE = Retained earnings

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	102 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	25 000
	<u>127 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(125 000)
Goodwill (parent)	<u>R2 000</u>

Other alternative journal entries for J1.2 (regarding the unrealised gain on the **plant sold by S Ltd**, while also working with the asset accounts (plant, accumulated depreciation and deferred tax, which all effectively cancel out) as in chapter 5, and then realising the balance with the loss of control) could also be as follows:

		Dr R	Cr R
J1.2.1	Retained earnings (opening balance of subsidiary attributable to parent) (SCE) $((10\,000 - 2\,000) \times 73\%) = 5\,840 \times 80\%$ (C5) Non-controlling interests (opening balance of subsidiary) (SCE) $(5\,840 \times 20\%)$ (C5) Accumulated depreciation (SFP) (C5) Deferred tax (SFP) $((10\,000 - 2\,000) \times 27\%)$ (C5) Plant (SFP) (P) Elimination of unrealised intragroup gain included in plant and recognition of portion realised to the beginning of the current year through depreciation, after tax	4 672 1 168 2 000 2 160	10 000
J1.2.2	Accumulated depreciation (SFP) $(10\,000/5 \text{ years} \times 3/12)$ (C5) Cost of sales (P/L) (realisation through depreciation) (C5) Income tax expense (P/L) $(500 \times 27\%)$ (C5) Deferred tax (SFP) Non-controlling interests (P/L) $((500 - 135) \times 20\%)$ Non-controlling interests (SCE) (current year's interests in profit) Recognition of portion of the unrealised intragroup gain realised in the first three months with related tax effect and non-controlling interests	500 135 73	500 135 73
J1.2.3	Plant (SFP) (P) Accumulated depreciation (SFP) $(2\,000(J1.2.1) + 500(J1.2.2))$ Gain on disposal of subsidiary (group context) (P/L) Income tax expense (P/L) $(7\,500 \times 27\%)$ (C5) Deferred tax (SFP) $((2\,160(J1.2.1) - 135(J1.2.2))$ Non-controlling interests (P/L) $((7\,500 - 2\,025) \times 20\%)$ (C5) Non-controlling interests (SCE) (current year's interests in profit) Realisation of remaining unrealised intragroup gain with loss of control over subsidiary	10 000 2 025 1 095	2 500 7 500 2 025 1 095

Alternative journal entries for **J3** (regarding unrealised gain on the **patent sold by P Ltd**, while also working with the asset accounts (patent, accumulated amortisation and deferred tax, which all effectively cancel out) as in chapter 5, and then realising the balance with the loss of control) could also be as follows:

		Dr R	Cr R
J3.1	Retained earnings (opening balance of parent) (SCE) ((9 300 – 3 100) × 73%) (C6) Accumulated amortisation (SFP) (C6) Deferred tax (SFP) ((9 300 – 3 100) × 27%) (C6) Patent (SFP) Elimination of unrealised intragroup gain included in patent and recognition of portion realised to the beginning of the current year through amortisation, after tax	4 526 3 100 1 674	 9 300
J3.2	Accumulated amortisation (SFP) (9 300/3 years × 3/12) (C6) Cost of sales (amortisation) (P/L) Income tax expense (P/L) (775 × 27%) (C6) Deferred tax (SFP) Recognition of portion of unrealised intragroup gain realised in first three months with related tax effect	 775 209	 775 209
J3.3	Patent (SFP) (J3.1) Accumulated amortisation (SFP) (3 100(J3.1) + 775(J3.2)) Gain on disposal of subsidiary (group context) (P/L) Income tax expense (P/L) (5 425 × 27%) (C6) Deferred tax (SFP) ((1 674(J3.1) – 209(J3.2)) Realisation of remaining unrealised intragroup gain with loss of control over subsidiary	9 300 1 465	 3 875 5 425 1 465

C5 Calculations for unrealised profit on the sale of the plant by S Ltd

The unrealised profit and the realisation thereof through depreciation, as well as with the loss of control, can be calculated as follows:

	Gross amount	Tax (27%)	Net amount	Attri- butable to NCI	Attri- butable to parent
Initial unrealised profit	(10 000)	2 700	(7 300)	1 460	(5 840)
Realised through depreciation during 20.26 (10 000/5 years)	2 000	(540)	1 460	(292)	1 168
Balance at the beginning of the current year	(8 000)	2 160	(5 840)	1 168	(4 672)
Realised through depreciation during 20.27 (10 000/5 years × 3/12)	500	(135)	365	(73)	292
Balance realised with the loss of control	(7 500)	2 025	(5 475)	1 095	(4 380)

C6 Calculations for unrealised profit on the sale of the patent by P Ltd

The unrealised profit and the realisation thereof through amortisation, as well as with the loss of control, can be calculated as follows:

	Gross amount	Tax (27%)	Net amount	Attributable to NCI	Attributable to parent
Initial unrealised profit	(9 300)	2 511	(6 789)	N/A	(6 789)
Realised through amortisation during 20.26 (9 300/3 years)	3 100	(837)	2 263	N/A	2 263
Balance at the beginning of the current year	(6 200)	1 674	(4 526)	N/A	(4 526)
Realised through amortisation during 20.27 (9 300/3 years × 3/12)	775	(209)	566	N/A	566
Balance realised with the loss of control	(5 425)	1 465	(3 960)	N/A	(3 960)



Comments

a Note that S Ltd was only a subsidiary of P Ltd for the **first three months** of the current year. Since S Ltd was not a subsidiary of P Ltd at the reporting date, S Ltd's individual financial statements will **not be combined** with those of the parent (P Ltd) as a starting point for consolidation. This means that the results for S Ltd (for the period that it was a subsidiary of P Ltd) would have to be **journalised into the consolidation**, as is seen in the pro forma consolidation journal entry (J1) above.

b Note that adjustments for the **unrealised profit** from the sale of the **plant by S Ltd to P Ltd** are effectively included in the **analysis** of the equity of S Ltd, as S Ltd was the selling entity, and the unrealised profit relates to the subsidiary's financial statements. The adjustment to the opening retained earnings of R5 840 (after-tax, see C5) is already included in the analysis of S Ltd, and is effectively already included in the amount of R49 728 journalised into the consolidation (J1). Furthermore, the adjustment to the depreciation of R500 ($R10\,000/5\text{ years} = R2\,000 \times 3/12 = R500$) (C5) and the tax effect thereof of R135 ($R500 \times 27\%$) that relates to the intragroup sale of the plant, are also already included in the analysis of S Ltd.

The profit of S Ltd attributable to P Ltd for the three months of the current year before control over S Ltd was lost (after the partial realisation of the unrealised profit from the sale of the plant through depreciation) amounts to R10 532. This amount is journalised into the consolidation (see J1) through the **various line items in profit or loss**, as follows:

Revenue ($111\,200 \times 3/12$)	27 800
Cost of sales ($(36\,000 \times 3/12) - 500$)	(8 500)
Income tax expense (P/L) ($(24\,000 \times 3/12) + 135$)	(6 135)
Profit after tax	13 165
Non-controlling interests in the profit	(2 633)
Profit attributable to P Ltd	10 532

continued

	Separate pro forma consolidation journal entries to account for the unrealised profit from the sale of the plant, and the partial realisation thereof through depreciation, are not needed as the adjusted retained earnings and profit per the analysis (as adjusted for the intragroup transaction) are journalised into the consolidation. The line items of S Ltd are not combined with those of the parent. Therefore, the unrealised gain cannot be eliminated as it would normally be done (as in chapter 5 of this work) (However, alternative journal entries may be used as illustrated above). c With the loss of control over a subsidiary, any unrealised intragroup profits are effectively realised, as the subsidiary is effectively sold in full to parties outside the group. The parent-subsidiary relationship ends, and all individual assets and liabilities of the subsidiary are effectively derecognised from the group (i.e. not included in the consolidated statement of financial position – since S Ltd was not a subsidiary of P Ltd at the reporting date, S Ltd's individual financial statements will not be combined with those of P Ltd as a starting point for consolidation). The realisation of intragroup profits with the sale of the subsidiary should, therefore, form part of the consolidated gain or loss with the loss of control. See comment (g) where the realisation of this is added to the group's profit with the loss of control. d As mentioned in (b) above, the unrealised profit from the sale of the plant, and the partial realisation thereof through depreciation, are already included in the analysis of S Ltd. This implies that when the consolidated gain or loss with the loss of control is calculated (proceeds less consolidated carrying amount as per the analysis of S Ltd), the realisation of any unrealised profit would automatically be included (and need not be added separately as when P Ltd was the selling entity) – see comment (f) for more detail. e The adjustments regarding the unrealised profit from the sale of the patent by P Ltd to S Ltd (see C6) are not included in the analysis of the equity of S Ltd, as P Ltd was the selling entity. f P Ltd disposed of all its shares in S Ltd and lost control over S Ltd. The gain or loss on the disposal of the interest can still be calculated using the steps in IFRS 10.B98 (as was done in the preceding examples), but adjustments should also be made for the realisation of intragroup profits. Furthermore, attention should be given to the various line items that relate to the consolidated gain or loss. The calculation in terms of IFRS 10.B98 results in the consolidated gain or loss on the loss of the control over the subsidiary, attributable to the owners of the parent (i.e. after tax and after the non-controlling interests). However, the realisation of the intragroup profits would also have a tax effect (separate line item), and it may affect the non-controlling interests in profit or loss (separate line item) if the unrealised intragroup profit relates to a partially-owned subsidiary.
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continued

The calculation of the consolidated gain or loss on the loss of the control over the subsidiary, attributable to the owners of the parent, is as follows:				
Derecognise assets (including goodwill) and liabilities on date control is lost (200 325 other net assets + 2 000 goodwill) (IFRS 10.B98(a))				(202 325)
Derecognise non-controlling interests (IFRS 10.B98(a))				40 065
Net asset value (attributable to parent) derecognised				(162 260)
Fair value of consideration received recognised (i.e. cash received) (IFRS 10.B98(b))				220 000
Recognise fair value of investment in former subsidiary retained (IFRS 10.B98(b)) (none retained)				0
Net gain on disposal of interest (group context) (IFRS 10.B98(d)) attributable to the owners of the parent				R57 740
(This amount is included in J1 above as: 60 860 – 2 025 – 1 095 , with the tax and non-controlling interests in respect of the realisation of the intragroup profits as separate line items)				
(The realisation of the unrealised gain from the sale of the plant by S Ltd to P Ltd (C5) (after tax) is effectively included in this amount – see comments (b) and (d) above.)				
Plus the realisation of the unrealised gain from the sale of the patent by P Ltd to S Ltd (C6) (after tax)				3 960
(In J3 above as 5 425 – 1 465 = 3 960)				
Total net gain on disposal of interest (group context) (IFRS 10.B98(d)) attributable to the owners of the parent (after tax)				R61 700
The total gain on the disposal of the subsidiary will be presented as follows in the consolidated profit or loss (as various line items):				
Other income (gain on disposal of interest) (60 860(J1)(S) + 5 425(J3)(P))				66 285
Income tax expense (2 025(J1)(S) + 1 465(J3)(P))				(3 490)
Profit after tax				62 795
Non-controlling interests (comment (d))				(1 095)
Total gain on disposal of interest (group context) (IFRS 10.B98(d)) attributable to the owners of the parent (after tax)				R61 700
Alternative calculation:	Gross	Tax	NCI	Parent
Gain on disposal (without unrealised profit) (J1.1)	53 360	*	N/A	53 360
Realisation of profit on plant (C5)	7 500	(2 025)	(1 095)	4 380
Amounts recognised in J1 above	60 860	(2 025)	(1 095)	57 740
Realisation of profit on patent (J3) (C6)	5 425	(1 465)	N/A	3 960
Total gain on disposal of interest attributable to the owners of the parent	R66 285	(R3 490)	(R1 095)	R61 700
* = Refer to comment (i) to example 13.6 for the discussion on the tax effect on the gain on the disposal of the subsidiary. Also, keep in mind that the actual tax paid by the parent on the disposal of the share investment has already been recognised by the parent. Refer to comment (b) to the information given in this example.				

continued

g	The gain on the disposal of the subsidiary can also (as an alternative) be calculated as follows:		
	Proceeds on disposal of interest		220 000
	Carrying amount of parent's interest in subsidiary lost		(166 640)
	Consolidated carrying amount of subsidiary (without the elimination of the unrealised profit)		(205 800)
	(R100 000 share capital + R93 000 retained earnings at beginning of year + R12 800 (R51 200 × 3/12) profit for first three months)		
	Portion attributable to non-controlling interests (205 800 × 20%)		41 160
	Goodwill of parent derecognised		(2 000)
	Gain on disposal of interest without unrealised profit		53 360
	Unrealised profit from the sale of the plant (C5) attributable to the parent, after tax		4 380
			57 740
	Unrealised profit from the sale of the patent (C6) attributable to the parent, after tax		3 960
	Total gain on disposal of interest attributable to the owners of the parent, after tax		R61 700
	h The other alternatives for the calculation of the group's gain on the disposal of the interest as outlined in the preceding examples may also be applicable in this example, but were not repeated here. There are arguably other alternatives to the journal entries as well.		

13.11 Changes of interest in complex groups

In the case of changes of interest in complex groups, no new principles apply. The complexity of the problems which may be encountered here simply requires a very careful application of the principles that have been dealt with in this chapter (as well as those in the next chapter).

Self-assessment questions

Question 13.1

The reporting date of the P Ltd Group is 31 December 20.23. The following information about P Ltd's interest in S Ltd is available:

P Ltd bought 10 000 shares in S Ltd (a 10% interest) on 1 January 20.21 for R40 000. P Ltd classified the investment as subsequently measured at fair value through other comprehensive income. Any amount in the mark-to-market reserve would be transferred to retained earnings with the disposal of the underlying investment.

Details of the 10% investment are as follows:

Number of shares	Fair value on 1/1/20.21	Fair value on 1/1/20.23	Fair value on 1/3/20.23
10 000	R40 000	R53 000	R57 000

S Ltd became a wholly-owned subsidiary of P Ltd on 1 March 20.23, when P Ltd bought the other 90 000 shares in S Ltd for R513 000. On the date of the business combination, the carrying amounts of the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3, except for the plant of S Ltd. The carrying amount of the plant on 1 March 20.23 was R500 000, while the fair value was R536 000.

P Ltd classified the investment in S Ltd at cost in its separate financial statements after it became a subsidiary. The group's accounting policy is to regard the fair value of the previously held investment, plus the consideration for the additional purchase whereby control over S Ltd was obtained, as the cost of the investment in the subsidiary under IAS 27.

The recognised equity of S Ltd on 1 March 20.23 was as follows:

	R	R
Share capital (100 000 shares)		50 000
Retained earnings: At the date of the business combination		455 595
Balance at the beginning of the year	360 000	
Profit for the period to 28 February 20.23:		
Revenue	390 000	
Cost of sales	(225 000)	
Other expenses	(13 500)	
Income tax expense	(40 905)	
Profit after tax	110 595	
Dividends paid	(15 000)	
Revaluation reserve at the beginning of the year (on land, after-tax)		20 000
Total equity		525 595

The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof.

Required

Prepare only the pro forma consolidation journal entries to account for the business combination of S Ltd in the consolidated financial statements of the P Ltd Group at the acquisition date of 1 March 20.23.

Suggested solution 13.1**Pro forma consolidation journal entries**

		Dr R	Cr R
J1	Mark-to-market reserve (SCE) $((57\,000 - 40\,000) \times 78,4\%)$ Retained earnings (SCE) Transfer of fair value adjustments previously recognised in mark-to-market reserve (OCI) to retained earnings with the deemed disposal of the equity interest previously held, at group level	13 328	13 328
J2	Plant (SFP) $(536\,000 - 500\,000)$ Deferred tax (SFP) $(36\,000 \times 27\%)$ Equity at acquisition (SCE) $((536\,000 - 500\,000) \times 73\%)$ Remeasurement of the plant to fair value at the business combination	36 000	9 720 26 280
J3	Share capital (S)(SCE) Equity at acquisition (SCE) Retained earnings – opening balance (S)(SCE) Revenue (S)(P/L) Cost of sales (S)(P/L) Other expenses (S)(P/L) Income tax expense (S)(P/L) Dividends paid (S)(SCE) Revaluation reserve – opening balance (S)(SCE) Investment in S Ltd (P)(SFP) $(57\,000 + 513\,000)$ Goodwill (SFP) Elimination of investment against equity acquired at the acquisition date	50 000 26 280 360 000 390 000 20 000 18 125	225 000 13 500 40 905 15 000 570 000

**Comment**

Remember that the consolidation procedures commence with combining all the line items of the subsidiary with those of the parent. Therefore, the full (12 months) current year's **profit or loss, other comprehensive income and equity movements** will be combined with those of the parent.

The **retained earnings** of the subsidiary at acquisition will consist of the balance at the beginning of the year, with the revenue, cost of sales, other expense, tax expense, etc., for the current year before the acquisition date. The pre-acquisition portion of these **separate line items must be eliminated at acquisition**. The retained earnings at acquisition will now consist of various line items that made up the balance thereof (opening balance, profit or loss, and dividends paid).

Question 13.2

P Ltd is listed on the JSE Ltd. P Ltd's financial director approached you to help them with the preparation of the consolidated financial statements of the P Ltd Group for the financial year ended 31 December 20.29.

The following abridged draft financial statements of P Ltd and S Ltd, in which P Ltd has an interest, are presented to you:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29		
	P Ltd	S Ltd
ASSETS		
Property, plant and equipment	110 000	42 000
Investment in S Ltd at cost:	19 800	–
1 200 shares purchased on 1 January 20.25 for R4 800		
400 shares purchased on 30 June 20.29 for R15 000		–
Current assets	28 000	35 000
Total assets	R157 800	R77 000
EQUITY AND LIABILITIES		
Share capital (6 000/2 000 shares)	6 000	2 000
Retained earnings	123 275	68 000
Total liabilities, including deferred tax	28 525	7 000
Total equity and liabilities	R157 800	R77 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29		
	P Ltd	S Ltd
Gross profit	5 000	6 000
Dividend received	1 600	–
Profit before tax	6 600	6 000
Income tax expense	(1 400)	(1 680)
PROFIT FOR THE YEAR	5 200	4 320
Other comprehensive income	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R5 200	R4 320

**STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.29**

	Retained earnings	
	P Ltd	S Ltd
Balance at 1 January 20.29	120 075	65 680
Changes in equity for 20.29		
Total comprehensive income for the year:		
Profit for the year	5 200	4 320
Other comprehensive income	—	—
Dividends: 31 December 20.29	(2 000)	(2 000)
Balance at 31 December 20.29	R123 275	R68 000

Additional information

- P Ltd acquired 1 200 of the issued ordinary shares (60% interest) in S Ltd on 1 January 20.25 for R4 800, on which date its retained earnings amounted to R4 000. On this date, the directors of P Ltd fair-valued all the identifiable assets and liabilities as required by **IFRS 3 Business Combination**. The following is relevant, and the fair value adjustment is material:
The plant and machinery of S Ltd had a carrying amount of R20 000 and a fair value of R22 500. All S Ltd's plant and machinery were purchased on 1 January 20.19 and were depreciated on a straight-line basis over 10 years. On 1 January 20.25, there was no change in the remaining useful life of four years with no residual value. The fair value adjustment was not recorded in the books of S Ltd.
- On 30 June 20.29, P Ltd purchased a further 400 ordinary shares (20% interest) for R15 000 in S Ltd from other shareholders.
- P Ltd elected to measure the non-controlling interests at fair value at the date of acquisition. On 1 January 20.25, the fair value of the non-controlling interests was R3 300 (when P Ltd obtained control over S Ltd).
- P Ltd classified the investment in S Ltd at cost in its separate financial statements.
- The profit of S Ltd was earned evenly during the current year.
- S Ltd purchases some of its inventories from P Ltd at cost plus 25%. S Ltd had the following inventories, which were bought from P Ltd, on hand at:
31 December 20.28 R15 000
31 December 20.29 R10 000
Inventory usually realises within three months.
- The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof. Assume that the companies had some permanent differences, causing their effective tax expense not to be 27% of their accounting profit.

Required

Prepare the consolidated financial statements of the P Ltd Group for the year ended 31 December 20.29. Notes are not required.

Suggested solution 13.2

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29	
ASSETS	
Non-current assets	
Goodwill (parent and NCI)	275
Property, plant and equipment (110 000(P) + 42 000(S))	152 000
Current assets (28 000(P) + 35 000(S) – 2 000 unrealised inventory)	61 000
Total assets	R213 275
EQUITY AND LIABILITIES	
Share capital	6 000
Retained earnings	159 152
Other components of equity (changes in ownership)	(947)
	164 205
Non-controlling interests	14 085
Total equity	178 290
Total liabilities (28 525 (P) – 540 (on inventory) + 7 000(S))	34 985
Total equity and liabilities	R213 275

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29	
Gross profit	
(5 000(P) + 6 000(S) + 3 000(opening inventory) – 2 000(closing inventory))	12 000
Income tax expense (1 400(P) + 1 680(S) + 810(tax relating to opening inventory) – 540(tax relating to closing inventory))	(3 350)
PROFIT FOR THE YEAR	8 650
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R8 650
Profit attributable to:	
Owners of the parent	7 354
Non-controlling interests (864 + 432)	1 296
	R8 650
Total comprehensive income attributable to:	
Owners of the parent	7 354
Non-controlling interests (864 + 432)	1 296
	R8 650

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29						
	Share capital	Retained earnings	Changes in ownership	Total	Non-controlling interests	Total equity
Balance at 1 January 20.29	6 000	* 153 798	–	159 798	! 27 242	187 040
Changes in equity for 20.29						
Total comprehensive income for the year:						
Profit for the year	–	7 354	–	7 354	1 296	8 650
Dividends	–	(2 000)	–	(2 000)	(400)	(2 400)
Purchase of interest	–	–	(947)	(947)	(14 053)	(15 000)
Balance at 31 December 20.29	R6 000	R159 152	(R947)	R164 205	R14 085	R178 290

* 120 075(P) + 35 913(S) – 2 190(opening inventory, after tax) = 153 798

! 3 300 + 23 942 = 27 242

Calculations**C1 Analysis of the owners' equity of S Ltd**

	Total	P Ltd 60% – 80%		NCI
		At	Since	
i At acquisition (1/1/20.25)				
Share capital	2 000	1 200		800
Retained earnings	4 000	2 400		1 600
Equity at acquisition ($2\,500 \times 73\%$)	1 825	1 095		730
	7 825	4 695		3 130
Equity represented by goodwill – Parent and NCI	275	105		170
Consideration and NCI	8 100	4 800		3 300
ii Since acquisition				
• To beginning of current year:				
Retained earnings ($65\,680 - 4\,000 - 1\,825$ extra depreciation as a result of fair value adjustment of PPE at acquisition for 4 years)	59 855		35 913	23 942
• Current year:				
Profit: 1/1/20.29–30/6/20.29 ($4\,320 \times 6/12$)	2 160		1 296	864
	70 115		37 209	28 106
Further acquisition ($28\,106(\text{NCI}) \times 20/40$)		14 053		(14 053)
Changes in ownership (equity) (per IFRS 10.23)		947		
Consideration and NCI		15 000		14 053
Profit: 1/7/20.29–31/12/20.29 ($4\,320 \times 6/12$)	2 160		1 728	432
Dividend: 31/12/20.29 (2 000)	(2 000)		(1 600)	(400)
	R70 275		R37 337	R14 085



Comments

a There may be various alternatives whereby the change in the owners' equity interest in the subsidiary can be calculated. Please refer to example 13.1 for some alternatives.

b The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) **(from the perspective of the NCI)**:

Fair value of the consideration received by NCI	15 000
Amount by which the non-controlling interests are adjusted (reserves acquired by parent from NCI) $(28\ 106 \times 20/40 = 14\ 053)$	(14 053)
NCI after transaction $((70\ 115 - 275\text{GW}) \times 20\% + (170\text{GW} \times 20/40))$	14 053
NCI before transaction $((70\ 115 - 275\text{GW}) \times 40\% + (170\text{GW} \times 40/40))$	(28 106)
Amount to be recognised directly in equity	<u>R947</u>

Through the parent's acquisition of another 20% interest in the subsidiary, 20% of the net asset value (excluding goodwill) $((70\ 115 - 275\text{GW}) \times 20\% = 13\ 968)$ was transferred from the non-controlling interests to the parent's interest. Furthermore, the non-controlling owners relinquished some of the goodwill $(170 \times 20/40 = 85)$ that was attributable to them to the parent. This resulted in a decrease in the non-controlling interests of R14 053 $(13\ 968 + 85)$.

Question 13.3

The following represents extracts from the condensed financial statements of S Ltd (that should still be accounted for in the consolidated financial statements of the P Ltd Group) for the period (11 months) ended 30 November 20.27. P Ltd lost control over S Ltd on 30 November 20.27. The reporting date of all the companies in the P Ltd Group is 31 December 20.27:

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE PERIOD ENDED 30 NOVEMBER 20.27

	S Ltd
Revenue	111 200
Total expenses	(36 000)
Profit before tax	75 200
Income tax expense	(20 304)
PROFIT FOR THE YEAR	54 896
Other comprehensive income:	
Items that will not be reclassified to profit or loss:	
Mark-to-market reserve (fair value adjustment on investment)	3 253
Income tax relating to items that will not be reclassified	(703)
Other comprehensive income for the year, net of tax	2 550
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>R57 446</u>

EXTRACT FROM STATEMENT OF CHANGES IN EQUITY FOR THE PERIOD ENDED 30 NOVEMBER 20.27		
	S Ltd	
	Mark-to-market reserve	Retained earnings
Balance at 1 January 20.27	1 700	173 000
Changes in equity for 20.27		
Total comprehensive income for the period:		
Profit for the period	–	54 896
Other comprehensive income	2 550	–
Balance at 30 November 20.27	R4 250	R227 896

Additional information

- P Ltd acquired 80% of the issued share capital of S Ltd (80 000 shares) on 1 January 20.23 for R102 000, when the share capital and retained earnings of S Ltd amounted to R100 000 and R17 700, respectively.
- P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date.
- On the date of the business combination, the carrying amounts of the assets and liabilities of S Ltd were regarded to be a fair reflection in terms of the requirements of IFRS 3, except for the machinery of S Ltd, which was considered to be worth R10 000 more than the carrying amount. On this date, the machinery's remaining useful life was estimated at three years, with no residual value. The machinery is used evenly over time.
- P Ltd accounted for the investment in S Ltd (as a subsidiary) at cost in its separate financial statements.
- On 30 November 20.27, P Ltd disposed of 70 000 shares in S Ltd for R245 000. The fair value of the remaining investment of P Ltd in S Ltd was R35 000 at the date of disposal of the interest.
After the loss of control, P Ltd classified the remaining investment in S Ltd as a financial asset under IFRS 9 in its individual financial statements. Subsequently, P Ltd recognised fair value adjustments in the mark-to-market reserve (other comprehensive income).
The disposal of the interest in the subsidiary did not comply with the criteria of IFRS 5 until the date of disposal thereof. The subsidiary does not represent a separate major line of business or geographical area of the group.
- The fair value of the remaining investment of P Ltd in S Ltd was R37 000 on 31 December 20.27.
- Any amount in the mark-to-market reserve would be transferred to retained earnings with the disposal of the underlying investment.
- The company tax rate is 27% and CGT is calculated at 80% thereof.

Required

- Prepare only the journal entries in the separate accounting records of P Ltd (including cash transactions) to account for the investment in S Ltd for the year ended 31 December 20.27. Ignore all taxes.

- b) Prepare only the pro forma consolidation journal entries to include S Ltd in the consolidated financial statements of the P Ltd Group for the year ended 31 December 20.27. The pro forma journal entry for the presentation of the non-controlling interests in the statement of changes in equity for the loss of control is not required. Ignore any tax regarding the loss of control.

Suggested solution 13.3

- a) The **actual** journal entries to recognise the **partial sale** of the share investment in the **separate** accounting records of **P Ltd** will be:

		Dr R	Cr R
J1	Bank (SFP) Investment in S Ltd (SFP) ($70\,000/80\,000 \times R102\,000(\text{cost})$) Profit on the sale of shares (P/L) Recording proceeds and profit on partial disposal of investment	245 000	89 250 155 750

The **actual** journal entries to recognise the **initial** remeasurement of the share investment in the **individual** accounting records of **P Ltd** will be:

		Dr R	Cr R
J2	Investment in S Ltd (SFP) ($35\,000 - (10\,000/80\,000 \times R102\,000(\text{cost}))$) Remeasurement gain on retained investment (P/L) Remeasurement gain on retained investment	22 250	22 250

The **actual** journal entries to recognise the **subsequent** remeasurement of the share investment in the **individual** accounting records of **P Ltd** will be:

		Dr R	Cr R
J3	Investment in S Ltd (SFP) ($37\,000 - 35\,000$) Mark-to-market reserve (OCI) Remeasurement gain on investment at reporting date	2 000	2 000

b) The **pro forma** consolidation journal entries regarding S Ltd will be:

		Dr R	Cr R
J1	Profit on the sale of shares (P) (P/L) Remeasurement gain on retained investment (P) (P/L) Retained earnings – Beginning of year (SCE) Mark-to-market reserve – Beginning of year (SCE) Revenue (P/L) Total expenses (P/L) Income tax expense (P/L) Non-controlling interests (P/L) (first 11 months) Mark-to-market reserve (OCI) Tax relating to mark-to-market reserve (OCI) Non-controlling interests (OCI) (first 11 months) Gain on disposal of interest (group context) (P/L) (comment (a)) Gain on disposal of interest (group context) (P/L) (Remeasurement gain) (comment (a)) Consolidation of subsidiary and recognition of disposal of interest	155 750 22 250 36 000 20 304 10 979 703 510 	 118 400 1 360 111 200 3 253 10 748 1 535
J2	Mark-to-market reserve (SCE) (4 250 × 80%, or 1 360 + 2 040 per the analysis) Retained earnings (SCE) (comment (b)) Transfer of mark-to-market reserve to retained earnings on loss of control over subsidiary in terms of IFRS 10.B99	 3 400 	 3 400

Calculations**C1 Analysis of the owners' equity of S Ltd – as subsidiary**

	Total	P Ltd 80%		NCI
		At	Since	
i At acquisition				
Share capital	100 000	80 000		20 000
Retained earnings	17 700	14 160		3 540
Equity at acquisition (10 000 × 73%)	7 300	5 840		1 460
	125 000	100 000		25 000
Equity represented by goodwill – Parent	2 000	2 000		–
Consideration and NCI	127 000	102 000		25 000
ii Since acquisition				
• To beginning of current year:				
Retained earnings (173 000 – 17 700 – 7 300 extra depreciation as a result of fair value adjustment of PPE at acquisition for 3 years)	148 000		118 400 RE	29 600
Mark-to-market reserve	1 700		1 360 MtM	340
• Current year:				
Profit: 1/1/20.27–30/11/20.27	54 896		43 917 RE	10 979
Mark-to-market reserve (OCI)	2 550		2 040 MtM	510
	334 146		162 317 RE 3 400 MtM	66 429
Loss of control over subsidiary:				
Derecognise assets (including goodwill), liabilities and NCI (IFRS 10.B98)	(334 146)	(102 000)	165 717 (165 717)	(66 429)
Transfer of mark-to-market reserve (IFRS 10.B99) (J2)			(3 400) MtM 3 400 RE	
	–	–	–	–

RE = Retained earnings; MtM = Mark-to-market reserve



Comments

- a If a parent loses control, as is the case with S Ltd here, the gain or loss on the disposal of the interest could be calculated as follows using IFRS 10.B98:

Derecognise assets (including goodwill) and liabilities on date control is lost (332 146 other net assets + 2 000 goodwill)	(334 146)
Derecognise non-controlling interests	66 429
Carrying amount of P Ltd's interest in S Ltd lost (102 000 + 165 717)	(267 717)
Recognise consideration received	245 000
Fair value of investment retained	35 000
Gain (consolidated) recognised in profit or loss	<u>R12 283</u>
The total gain should effectively be presented as a gain on the disposal of an interest in the subsidiary and a remeasurement gain on remeasuring the retained investment to fair value (IFRS 12.19). These items could be calculated as follows:	
Carrying amount of interest sold ($70/80 \times R267\,717$ (above))	(234 252)
Recognise consideration received	245 000
Profit on disposal	<u>R10 748</u>
Carrying amount of interest retained ($10/80 \times R267\,717$ (above))	(33 465)
Fair value of investment retained	35 000
Remeasurement gain	<u>R1 535</u>

- b With the loss of control over a subsidiary, any amount previously recognised in other comprehensive income, should be reclassified to profit or loss (where appropriate), or transferred directly to retained earnings if required in accordance with other IFRSs (refer to IFRS 10.B98(c) and B99), and in line with the entity's accounting policies (where relevant).

14

Changes resulting from the issue of additional shares by investees and other changes in ownership

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**Changes resulting from the issue of additional shares by investees
and other changes in ownership**

Same principles for changes in interest as in the previous chapter,
for the following transactions:

Capitalisation issue

Rights issue by subsidiary

No change in parent's interest
Increase in parent's interest
Decrease in parent's interest

Rights issue by associate

Increase in parent's interest
Decrease in parent's interest

Buy-back of shares by subsidiary

No change in parent's interest
Increase in parent's interest
Decrease in parent's interest

Buy-back of shares by associate

Loss of significant influence

Other changes in ownership

**Share-based payment by
subsidiary**

**Obtaining control through an agreement
and Loss of control through expiry
of an agreement and**

Introduction

The preceding chapter dealt with changes in the ownership of subsidiaries which primarily came about as a result of an action by the investor, i.e. **acquisition** of additional shares or **disposal** (or **partial disposal**) of interests in a subsidiary. This chapter deals mainly with the appropriate consolidation procedures that occur when an investee issues additional shares or buys back shares and other changes in ownership. The issue of additional shares can occur by way of a new issue, a capitalisation issue or a rights issue.

It is important to note that the concepts and procedures followed for the accounting treatment of changes in the parent's/investor's interest in a subsidiary/associate/joint venture in this chapter are similar to those covered in the preceding chapters, and the **same accounting principles** will be applied. Furthermore, the **same presentation and disclosure requirements** should be adhered to as were discussed and illustrated in the preceding chapters. The presentation and disclosure examples of the preceding chapters are thus equally applicable to this chapter. These aspects are thus not repeated in this chapter.

Changes in subsidiaries

Issue of shares

14.1 Issue of capitalisation shares

If authorised to do so by its memorandum of incorporation, a company may use its retained earnings and other reserves to issue fully paid-up capitalisation shares instead of distributing a cash dividend. A capitalisation share dividend is merely a book entry executed by transferring reserves or retained earnings to share capital. This amounts to a **capitalisation of retained earnings** or **other reserves**.

The amount thus **capitalised** represents reserves of the group and must be disclosed as such. The same principle applies should the investment be realised at any point in time. In the consolidation worksheet, the capitalisation issue is merely reversed as a consolidation adjustment **before** the analysis of the owners' equity of the subsidiary is prepared. The total equity of the subsidiary to be analysed still remains the same, although the individual components of the equity differ from the composition **before** the capitalisation issue.

The issue of capitalisation shares by a company to its owners does **not normally result in a change** in the percentage of the owners' equity of the various owners. Thus, a capitalisation issue by a partially-owned subsidiary will normally be taken up by its parent and the non-controlling interests in proportion to their existing ownership before the capitalisation issue.

From the investors' point of view, the receipt of capitalisation shares, regardless of whether the investment is in a subsidiary or not, is merely recorded by means of a memorandum entry, as a capitalisation issue is not regarded as income. An important fact, which must be borne in mind on consolidation after such a capitalisation issue, is that the issue does not normally change the pro-rata interest in the investee. However, a change in the proportionate owners' equity could result from **fractional dealings** in shares, which are treated similarly to changes through a rights issue.

14.2 Rights issue by a subsidiary

A rights issue of shares takes place when the right to apply for the shares (which are issued to obtain cash funds) is at first only granted to existing owners of a company in proportion to their existing ownership. The existing owners can then either decide to exercise their rights and thus acquire further shares in the company, or in the case of **renounceable** rights issues, sell their rights to apply for additional shares to someone else.

In the case of a parent/subsidiary relationship, the parent, as the controlling owner, frequently underwrites the rights issue of a subsidiary. If all the owners exercise their rights to take up all the shares offered to them, the relative interests of all the owners remain exactly the same. The parent's relative interest could, however, **increase** if the parent takes up more shares than those originally allocated to it (e.g. due to underwriting the rights issue where the parent had to take up those shares that were not taken up by the other owners).

In instances where the parent desires to dilute its owners' equity in a subsidiary, it can undertake not to take up its full share of the rights issue. The parent can even relinquish its rights in favour of a particular investor whom the parent would like to see become involved in the group. Both these actions will result in the relative interest of the parent being **decreased** (diluted).

The accounting treatment of the change in the parent's interest in a subsidiary through a rights issue is similar to the treatment explained in the preceding chapter, and only one scenario is illustrated below.

Example 14.1	Rights issue by a subsidiary resulting in an increase of the interest of the parent (control is not lost in the rights issue) and the status does not change as the subsidiary remains a subsidiary (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)
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The following represents the abridged financial statements of P Ltd and its subsidiary S Ltd at 31 December 20.29.

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29		
	P Ltd	S Ltd
ASSETS		
Inventory	342 000	415 000
Investment in S Ltd: 166 000 shares at cost (150 000 + 92 000)	242 000	—
Total assets	R584 000	R415 000
EQUITY AND LIABILITIES		
Share capital (300 000/200 000 shares, after the rights issue)	300 000	250 000
Retained earnings	284 000	165 000
Total equity and liabilities	R584 000	R415 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29		
	P Ltd	S Ltd
Revenue	500 000	300 000
Cost of sales	(300 000)	(200 000)
Gross profit	200 000	100 000
Other income (dividend received)	16 000	—
Profit before tax	216 000	100 000
Income tax expense	(80 000)	(40 000)
PROFIT FOR THE YEAR	136 000	60 000
Other comprehensive income	—	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R136 000	R60 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29		
	Retained earnings	
	P Ltd	S Ltd
Balance at 1 January 20.29	164 000	125 000
Changes in equity for 20.29		
Total comprehensive income for the year		
Profit for the year	136 000	60 000
Other comprehensive income	—	—
Dividend paid: 31/5/20.29	(16 000)	(20 000)
Balance at 31 December 20.29	R284 000	R165 000

Additional information

- 1 P Ltd acquired 120 000 shares (80% interest) in S Ltd on 1 January 20.27 for R150 000 when the equity of S Ltd consisted of the following:

Share capital (150 000 shares)	150 000
Retained earnings	30 000
	R180 000

- 2 On 30 June 20.29, S Ltd made a **rights issue** of 1 share for every 3 shares previously held, at R2.00 per share.

- 3 The rights issue was taken up as follows: **Number of shares**
- | | |
|---------------------------|--------|
| Non-controlling interests | 4 000 |
| P Ltd | 46 000 |

- 4 S Ltd's profit after tax for 20.29 accrued evenly.

- 5 P Ltd classified the investment in S Ltd at cost in its separate financial statements.

- 6 P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

The following **actual** journal entry will be processed in the **individual** financial statements of **S Ltd**:

	Dr R	Cr R
Bank (SFP) (50 000 shares × R2 per share)	100 000	
Share capital (SCE)		100 000
Rights issue of shares		

The following **actual** journal entry will be processed in the **separate** financial statements of **P Ltd**:

	Dr R	Cr R
Investment in S Ltd (SFP)	92 000	
Bank (SFP) (46 000 shares × R2,00 per share)		92 000
Additional investment in shares of S Ltd		



Comment

The respective journal entries by the parent (the investment) and the subsidiary (the share capital) must be reversed upon consolidation (where control of a subsidiary is not obtained or lost) as **common items are eliminated**, with the recognition of the change in the non-controlling interests (similar to the main elimination journal entry at acquisition). The calculation and accounting treatment of the change in ownership recognised within equity is similar to paragraph 13.3 and 13.7.

Solution 14.1

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29	
ASSETS	
Non-current assets	
Goodwill (parent only)	6 000
Current assets	
Inventory (342 000(P) + 415 000(S))	757 000
Total assets	R763 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	300 000
Retained earnings	392 900
Other components of equity (changes in ownership)	(450)
	692 450
Non-controlling interests	70 550
Total equity	763 000
Total equity and liabilities	R763 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29	
Revenue (500 000(P) + 300 000(S))	800 000
Cost of sales (300 000(P) + 200 000(S))	(500 000)
Gross profit before tax	300 000
Income tax expense (80 000(P) + 40 000(S))	(120 000)
PROFIT FOR THE YEAR	180 000
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R180 000
Profit attributable to:	
Owners of the parent	168 900
Non-controlling interests (6 000 + 5 100)	11 100
	R180 000
Total comprehensive income attributable to:	
Owners of the parent	168 900
Non-controlling interests (6 000 + 5 100)	11 100
	R180 000

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29						
	Share capital	Retained earnings	Changes in ownership	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.29	300 000	* 240 000	–	540 000	§ 55 000	595 000
Changes in equity for 20.29						
Dividends	–	(16 000)	–	(16 000)	(4 000)	(20 000)
Total comprehensive income for the year:						
Profit for the year	–	168 900	–	168 900	11 100	180 000
Rights issue	–	–	(450)	(450)	8 450	8 000
Balance at 31 Dec 20.29	R300 000	# R392 900	(R450)	R692 450	R70 550	R763 000

* 164 000(P) + 76 000(S) = 240 000

284 000(P) + 108 900(S) = 392 900

§ 36 000 + 19 000 = 55 000

Calculations

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 80%–83%		NCI
		At	Since	
i At acquisition (1/1/20.27)				
Share capital	150 000	120 000		30 000
Retained earnings	30 000	24 000		6 000
	180 000	144 000		36 000
Equity represented by goodwill – Parent	6 000	6 000		–
Consideration and NCI	186 000	150 000		36 000
ii Since acquisition				
• To beginning of current year : Retained earnings (125 000 – 30 000)	95 000		76 000	19 000
• Current year:				
Profit: 1/1/20.29–30/6/20.29 (60 000 × 6/12)	30 000		24 000	6 000
Dividend paid: 31/5/20.29 (20 000)	(20 000)		(16 000)	(4 000)
Owners' equity before rights issue	291 000		84 000	57 000
Rights issue (30/6/20.29)				
Shares issued	100 000	92 000		8 000
Changes in ownership (equity)		(450)		450
	391 000			65 450
Profit: 1/7/20.29–31/12/20.29	30 000		24 900	5 100
	R421 000		R108 900	R70 550



Comments

a P Ltd's percentage owners' equity in S Ltd can be calculated as follows:

To 30/6/20.29 (120 000/150 000 shares in issue)	80%
Since 1/7/20.29 (166 000/200 000 issued shares)	83%

Consequently, there is no loss of control. However, there is a change in the ownership interest that should be recognised directly in equity in terms of IFRS 10.23.

b The exact amount paid by P Ltd and the non-controlling shareholders for the shares taken up by them respectively is analysed in the "At" and "Non-controlling interest" columns. This approach resembles the pro forma consolidation journal entry (see J5) to account for the rights issue and any change in ownership. An alternative approach for the calculations for a rights issue in the analysis is given below.

c The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (**from the perspective of the NCI**):

Fair value of the consideration paid by NCI for new shares issued to them	(8 000)
Amount by which the non-controlling interests are adjusted	8 450
NCI after rights issue ((391 000 – 6 000GW) × 17%)	65 450
NCI before rights issue ((291 000 – 6 000GW) × 20%)	(57 000)
Amount to be recognised directly in equity	R450

continued

	The NCI decreased by 3% in this example (from 20% to 17%). Thus the NCI ceded 3% of its equity to P Ltd's new parcel of shares. Also remember that, due to the fact that goodwill was not calculated for the NCI in this example, there is no equity that is represented by goodwill that should be reattributed to the parent. Thus, the calculation can also be performed as follows: <table><tr><td>Fair value of the consideration paid by NCI for new shares issued to them</td><td>(8 000)</td></tr><tr><td>Amount by which the non-controlling interests are adjusted</td><td>8 450</td></tr><tr><td>Previous equity interest held relinquished (57 000 × 3/20)</td><td>(8 550)</td></tr><tr><td>Increased equity attributable to NCI as a result of the rights issue (100 000 × 17%)</td><td>17 000</td></tr><tr><td></td><td><u>R450</u></td></tr></table> Amount to be recognised directly in equity	Fair value of the consideration paid by NCI for new shares issued to them	(8 000)	Amount by which the non-controlling interests are adjusted	8 450	Previous equity interest held relinquished (57 000 × 3/20)	(8 550)	Increased equity attributable to NCI as a result of the rights issue (100 000 × 17%)	17 000		<u>R450</u>
Fair value of the consideration paid by NCI for new shares issued to them	(8 000)										
Amount by which the non-controlling interests are adjusted	8 450										
Previous equity interest held relinquished (57 000 × 3/20)	(8 550)										
Increased equity attributable to NCI as a result of the rights issue (100 000 × 17%)	17 000										
	<u>R450</u>										
d	The amount for the change in ownership recognised in equity can also be calculated as follows (from the perspective of the parent): <table><tr><td>Fair value of the consideration paid by the parent for new shares issued</td><td>(92 000)</td></tr><tr><td>Increase in P Ltd owners' equity through rights issue:</td><td>91 550</td></tr><tr><td>Owners' equity held by P Ltd after rights issue (((391 000 – 6 000GW) × 83%) + 6 000GW)</td><td>325 550</td></tr><tr><td>Owners' equity held by P Ltd before rights issue (((291 000 – 6 000GW) × 80%) + 6 000GW)</td><td>(234 000)</td></tr><tr><td></td><td><u>(R450)</u></td></tr></table> Amount to be recognised directly in equity The amount of R450 is the amount paid in excess of the carrying amount of the interest acquired, being R91 550. Goodwill is excluded from total owners' equity in the calculation above since, although it forms part of total owners' equity, it does not represent 100% of the goodwill, but only the parent's portion. This is due to the non-controlling interests being measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date.	Fair value of the consideration paid by the parent for new shares issued	(92 000)	Increase in P Ltd owners' equity through rights issue:	91 550	Owners' equity held by P Ltd after rights issue (((391 000 – 6 000GW) × 83%) + 6 000GW)	325 550	Owners' equity held by P Ltd before rights issue (((291 000 – 6 000GW) × 80%) + 6 000GW)	(234 000)		<u>(R450)</u>
Fair value of the consideration paid by the parent for new shares issued	(92 000)										
Increase in P Ltd owners' equity through rights issue:	91 550										
Owners' equity held by P Ltd after rights issue (((391 000 – 6 000GW) × 83%) + 6 000GW)	325 550										
Owners' equity held by P Ltd before rights issue (((291 000 – 6 000GW) × 80%) + 6 000GW)	(234 000)										
	<u>(R450)</u>										
e	The difference of R450 results from 6 000 new shares additionally taken up by P Ltd as the issue price is higher than the net asset value of the shares after the issue ((R385 000/200 000 shares – R2,00) × 6 000 shares).										
f	When the interest of the parent changes (without gaining or losing control) (e.g., 80% – 83%) as a result of a rights issue, no gain or loss on the rights issue, additional goodwill, or gain from a bargain purchase can be recognised in terms of IFRS 10.23. Instead, any difference between the consideration paid for the shares and the increase in owners' equity is attributed to changes in ownership directly in equity, as is indicated above.										

C1.1 Alternative approach for the rights issue in the analysis

	Total	P Ltd 80%–83%		NCI
		At	Since	
Owners' equity before rights issue	291 000		84 000	57 000
Rights issue (30/6/20.29)				
Shares issued (83%:17%)	100 000	83 000		17 000
Transfer from NCI (57 000 × 3/20)		8 550		(8 550)
	391 000	91 550		
Changes in ownership (equity)		450		
Consideration and NCI		92 000		65 450

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	150 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	36 000
	186 000
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(180 000)
Goodwill (parent)	R6 000

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (parent only) Non-controlling interests (SCE) Investment in S Ltd (SFP) Main elimination journal entry	150 000 30 000 6 000	36 000 150 000
J2	Retained earnings – Beginning of year (SCE) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of retained earnings	19 000	19 000
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit before rights issue	6 000	6 000
J4	Dividend received (P/L) Non-controlling interests (SCE) Dividend paid (SCE) Elimination of intragroup dividend	16 000 4 000	20 000
J5	Share capital (SCE) Changes in ownership (SCE) Non-controlling interests (SCE) (8 000 + 450) Investment in S Ltd (SFP) (46 000 × R2,00) Elimination of rights issue transaction	100 000 450	8 450 92 000
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit after rights issue	5 100	5 100

In the example above, the rights issues of the subsidiary did not result in a loss of control. In terms of IFRS 10.23, such transactions between equity participants are recognised within equity. In some instances, a rights issue by an investee (e.g. an associate or joint venture) may lead to the investor **gaining control**. In such a case, the investor would treat the acquisition of the subsidiary as a **business combination**. The same principles (refer to IFRS 3) would be followed as discussed in chapter 9 and chapter 13 (e.g., in cases where the associate or joint venture would become a

subsidiary). A rights issue of a subsidiary may also lead to the parent **losing control** over the subsidiary. The same principles (refer to IFRS 10.25 and B98) would be followed as was discussed in chapter 13 (e.g. where the subsidiary would become an associate).

Buy-back of shares

14.3 Buy-back of shares by a subsidiary

Entities sometimes buy back their issued share capital from the existing owners to avoid issuing new shares or to avoid amending their authorised share capital. The entity may require these shares for issue in employee-share participation schemes, share-based payment transactions in terms of **IFRS 2 Share-based Payment**, or many more similar transactions.

With a buy-back of shares by a subsidiary, the parent receives cash from the subsidiary for the shares bought back. The accounting treatment for a share buy-back within a group is done by applying the methods used in the previous chapter. It should still be borne in mind that those share buy-back transactions leading to a change in ownership **but not resulting in the loss of control** should be treated as **equity transactions** (i.e. transactions with owners **in their capacity as owners**) in terms of IFRS 10.23. Furthermore, it should be noted that where there is a loss of control due to a share buy-back transaction, such loss of control is regarded as a significant event in terms of IFRS 10.BCZ180–183, and in most cases leads to the remeasurement, at fair value, of the remaining investment in the investee in terms of IFRS 10.25(b). Note that this principle also applies to the loss of significant influence or joint control where the retained interest is a financial asset (IAS 28.22(b)). The situation is similar to the principles dealt with under the disposal of an interest in an entity, as was illustrated in the previous chapters.

The following summarises the approach:

- ☐ Share buy-back with no loss of control:
gain or loss to be treated as **equity transaction** (i.e. changes in ownership) and no remeasurement of remaining investment at the date of the share buy-back;
- ☐ Share buy-back with no loss of significant influence or joint control:
gain or loss to be recognised as **gain or loss on share buy-back** in profit or loss and no remeasurement of remaining investment at the date of the share buy-back;
- ☐ Share buy-back with a loss of control, significant influence or joint control:
gain or loss recognised as **gain or loss on share buy-back in profit or loss** in terms of IFRS 10.25(b) and IAS 28.22(b). Any remaining investment is remeasured at **fair value** at the date of loss of control, significant influence or joint control; and
- ☐ Share buy-back in which investor **obtains control**, significant influence or joint control:
the previously held investment is measured at its fair value (IFRS 3.42 and IAS 28.26). The acquisition of control is accounted for as a **business combination** (goodwill or gain from a bargain purchase is recognised).

The journal entry processed in the **separate** financial statements of the **parent** is similar to a normal journal entry to recognise the disposal of an equity investment (i.e. shares in another company) in the accounting records (see paragraph 13.6). The journal entry arising in the **parent's separate** financial statements will be reversed upon consolidation where control was not lost or obtained.

The shares bought back by an **investee** (subsidiary, associate or joint venture) are referred to as "**treasury shares**" in terms of IAS 32.33–.34. When an entity reacquires its own equity shares, those shares shall be **deducted from equity** (share capital and retained earnings). No gain or loss on the buy-back of shares shall be recognised in profit or loss in the entity's individual financial statements. The amount of treasury shares held is disclosed separately either in the statement of financial position, statement of changes in equity or in the notes, in accordance with IAS 1. Disclosure in accordance with **IAS 24 Related Party Disclosures** is also required if the entity reacquires its own shares from related parties (e.g. the parent).

A share buy-back by a subsidiary would arguably result in a change in the parent's interest in the subsidiary without the parent gaining or losing control. In such cases, the only new principle is the recognition of the journal entry by the investee to adjust its own equity in respect of the buy-back information. Note that the debits per the journal entry by the subsidiary (see below) are processed in the total column of the analysis of ownership interest. This is logical, as the investee is reducing its own equity by the amount of the share capital bought back, as well as the premium (additional amount over and above share capital) paid on the buy-back of the shares, which is funded from other reserves (e.g. retained earnings). Once again, these adjustments have to be allocated to the parent and the non-controlling interests.

Example 14.2	Buy-back of shares by a subsidiary where there is no change in the status as the subsidiary remains a subsidiary (there is no loss of control) and a decrease in the parent's interest occurs due to the share buy-back (NCI is measured at fair value at the acquisition date)
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The following are the abridged financial statements of P Ltd and its subsidiary S Ltd at 31 December 20.29:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29		
	P Ltd	S Ltd
ASSETS		
Inventory	484 000	265 000
Investment in S Ltd at cost (240 000 – 56 000)	184 000	–
Total assets	R668 000	R265 000
EQUITY AND LIABILITIES		
Share capital (300 000/120 000 shares after the share buy-back)	300 000	200 000
Retained earnings	368 000	65 000
Total equity and liabilities	R668 000	R265 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29		
	P Ltd	S Ltd
Revenue	500 000	300 000
Cost of sales	(300 000)	(200 000)
Gross profit	200 000	100 000
Other income (gain on buy-back of shares)	84 000	–
Other income (dividend received)	16 000	–
Profit before tax	300 000	100 000
Income tax expense	(80 000)	(40 000)
PROFIT FOR THE YEAR	220 000	60 000
Other comprehensive income	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R220 000	R60 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29		
	Retained earnings	
	P Ltd	S Ltd
Balance at 1 January 20.29	164 000	125 000
Changes in equity for 20.29		
Total comprehensive income for the year:		
Profit for the year	220 000	60 000
Dividend paid: 31 May 20.29	(16 000)	(20 000)
Buy-back of shares	–	(100 000)
Balance at 31 December 20.29	R368 000	R65 000

Additional information

- 1 P Ltd acquired 120 000 shares in S Ltd (80% interest) on 1 January 20.27 for R240 000, when the equity of S Ltd consisted of the following:

Share capital (150 000 shares)	250 000
Retained earnings	30 000
	<u>R280 000</u>

The fair value of the NCI was R60 000 at the date of acquisition.

- 2 On 30 June 20.29, S Ltd bought back 30 000 shares at R5,00 per share. 28 000 of these shares were bought back from P Ltd, while the remaining 2 000 shares were bought back from the non-controlling interests.
- 3 S Ltd's profit accrued evenly during 20.29.
- 4 P Ltd accounted for the investment in S Ltd at cost in its separate financial statements.
- 5 P Ltd elected to measure the non-controlling interests at their fair value at the acquisition date.
- 6 Ignore any tax consequences for S Ltd in respect of the share buy-back.

Changes resulting from the issue of additional shares by investees

From the information provided, it is evident that the following **actual** journal entry was processed in the **separate** financial statements of P Ltd:

	Dr R	Cr R
Bank (SFP) (28 000 shares × R5,00 per share)	140 000	
Investment in S Ltd (SFP)(1)		56 000
Gain on buy-back of shares (P/L)		84 000
Recording proceeds and profit on the sale of shares		

(1) $28\,000/120\,000 \times R240\,000 = 56\,000$, or $28\,000/92\,000 \times R184\,000 = R56\,000$

From the information provided, it is also evident that the following **actual** journal entry was processed in the **individual** financial statements of S Ltd:

	Dr R	Cr R
Share capital (SCE) (30 000/150 000 shares × R250 000)	50 000	
Retained earnings (SCE) (balancing)	100 000	
Bank (SFP) (30 000 shares × R5 per share)		150 000
Recording of share buy-back transaction		



Comment

These journals (except the bank account) must be reversed (i.e. elimination of common items) upon consolidation of the parent (P Ltd) and the subsidiary (S Ltd), as the share buy-back represents an **intragroup transaction** between P Ltd and S Ltd at the group level. This reversal (i.e. elimination of common items) is done in J6 below, after which the adjustment to non-controlling interests and the change of ownership, if any, are recognised in equity (IFRS 10.B96).

Solution 14.2

The consolidated financial statements of P Ltd and subsidiary S Ltd for the year ended 31 December 20.29 will be prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29	
ASSETS	
Non-current assets	
Goodwill (parent and NCI) (comment (a))	20 000
Current assets	
Inventory (484 000(P) + 265 000(S))	749 000
Total assets	R769 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital (P)	300 000
Retained earnings (368 000(P) – 84 000(J6) profit reversed + 107 000(S) analysis)	391 000
Other components of equity (changes in ownership)	11 500
	702 500
Non-controlling interests	66 500
Total equity	769 000
Total equity and liabilities	R769 000



Comment

Note that goodwill is not realised, as control is not relinquished by the parent (P Ltd) in this example. Goodwill is, however, reattributed proportionately to the NCI in this example because of the decrease in the ownership interest of the parent (P Ltd) and the NCI being measured at fair value at the acquisition date (i.e. goodwill was initially calculated for the NCI and for the parent (P Ltd)).

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29	
Revenue (500 000(P) + 300 000(S))	800 000
Cost of sales (300 000(P) + 200 000(S))	(500 000)
Gross profit before tax	300 000
Other income (no gain on buy-back is recognised here)	–
Profit before tax	300 000
Income tax expense (80 000(P) + 40 000(S))	(120 000)
PROFIT FOR THE YEAR	180 000
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R180 000
Profit attributable to:	
Owners of the parent	167 000
Non-controlling interests (6 000 + 7 000)	13 000
	R180 000
Total comprehensive income attributable to:	
Owners of the parent	167 000
Non-controlling interests (6 000 + 7 000)	13 000
	R180 000

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29						
	Share capital	Retained earnings	Changes in owner-ship	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.29	300 000	# 240 000	–	540 000	! 79 000	619 000
Changes in equity for 20.29						
Dividends	–	(16 000)	–	(16 000)	(4 000)	(20 000)
Total comprehensive income for the year:						
Profit for the year	–	167 000	–	167 000	@ 13 000	180 000
Share buy-back	–	–	11 500	11 500	* (21 500)	(10 000)
Balance at 31 Dec 20.29	R300 000	R391 000	R11 500	R702 500	R66 500	R769 000

164 000(P) + 76 000(S) = 240 000

! 60 000 + 19 000 = 79 000

@ 6 000(before buy-back) + 7 000(after buy-back) = 13 000

* 10 000 + 11 500 = 21 500(see analysis)

Calculations

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 80%–76,67%		NCI
		At	Since	
i At acquisition (1/1/20.27)				
Share capital	250 000	200 000		50 000
Retained earnings	30 000	24 000		6 000
	280 000	224 000		56 000
Equity represented by goodwill – Parent and NCI	20 000	16 000		4 000
Consideration and NCI	300 000	240 000		60 000
ii Since acquisition				
• To beginning of current year: Retained earnings (125 000 – 30 000)	95 000		76 000	19 000
• Current year: Profit: 1/1/20.29–30/6/20.29 Dividend: 31/5/20.29	30 000 (20 000)		24 000 (16 000)	6 000 (4 000)
	405 000		84 000	81 000
Share buy-back Share capital and retained earnings utilised (100 000 + 50 000) (comment (b)) Changes in ownership (equity)	(150 000)	(140 000) 11 500		(10 000) (11 500)
	255 000 30 000		23 000	59 500 7 000
Profit: 1/7/20.29–31/12/20.29	R285 000		R107 000	R66 500



Comments

- a P Ltd's percentage owners' equity in S Ltd can be calculated as follows:

To 30/6/20.29 (120 000/150 000 shares in issue)	80%
Since 1/7/20.29 ((120 000 – 28 000)/(150 000 – 30 000) shares in issue)	76,67%

Consequently, there is no loss of control. However, there is a change in the ownership interest that should be recognised directly in equity in terms of IFRS 10.23. The parent's ownership interest in the subsidiary decreased as the subsidiary bought back proportionately more shares from the parent company than from the other owners (i.e. the buy-back does not take place in the same proportion as the existing ownership).

- b The exact amount received by P Ltd and the non-controlling shareholders for the shares bought back from them respectively is analysed in the "At" and "Non-controlling interest" columns. P Ltd received R140 000 (28 000 shares × R5), and the non-controlling shareholders received R10 000 (2 000 shares × R5). This approach resembles the pro forma consolidation journal entry (see J6) to account for the buy-back and any change in ownership.

- c The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (**from the perspective of the NCI**):

Fair value of the consideration received by NCI for shares bought back (2 000 shares × R5)	10 000
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Amount by which the non-controlling interests are adjusted	(21 500)
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NCI after buy-back ((255 000 – 20 000GW) × 23,33%) + (4 000 initial GW of NCI) + (16 000 GW of parent × 3,33/80) relinquished to NCI)	59 500
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NCI before buy-back ((405 000 – 20 000GW) × 20%) + (4 000 initial GW of NCI)	(81 000)
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Amount to be recognised directly in equity	<u>(R11 500)</u>
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The amount for the change in ownership recognised in equity can also be calculated as follows (**from the perspective of the parent**):

Fair value of the consideration received by parent for shares bought back (28 000 shares × R5)	140 000
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Decrease in P Ltd owners' equity through buy-back:	(128 500)
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Owners' equity held by P Ltd after buy-back (((255 000 – 20 000GW) × 76,67%) + 16 000GW – (16 000 GW of parent × 3,33/80) relinquished to NCI)	195 500
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Owners' equity held by P Ltd before buy-back (((405 000 – 20 000GW) × 80%) + 16 000GW)	(324 000)
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Amount to be recognised directly in equity	<u>R11 500</u>
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Note in this case that the equity represented by the goodwill amount forms part of the calculations. This is because the NCI is measured at its **fair value** at the acquisition date and, therefore, goodwill is measured for all owners. With the change in the ownership interest as a result of the buy-back, P Ltd effectively relinquished some of its goodwill to the non-controlling interests.

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	240 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	60 000
	<u>300 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(280 000)
Goodwill (parent and NCI)	<u>R20 000</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (parent and NCI) Investment in S Ltd (SFP) Non-controlling interests (SCE) Main elimination journal entry at the acquisition date	250 000 30 000 20 000	240 000 60 000
J2	Retained earnings (SCE) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of retained earnings	19 000	19 000
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit before buy-back	6 000	6 000
J4	Dividend received (P/L) Non-controlling interests (SCE) Dividend paid (SCE) Elimination of intragroup dividend	16 000 4 000	20 000
J5	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit after buy-back	7 000	7 000
J6	Non-controlling interests (SCE) (10 000 + 11 500) Investment in S Ltd (SCE) (reverse over-elimination) Other income (gain on share buy-back) (P)(P/L) Share capital (SCE) Retained earnings (SCE) Changes in ownership (equity) (SCE) Elimination of share buy-back transaction	21 500 56 000 84 000	50 000 100 000 11 500



Comments

- a Note that pro forma consolidation journal entries are processed in chronological order. The historical cost price of the investment in S Ltd (as per P Ltd's **separate** financial statements) is only R184 000 after the recognition of the share buy-back. The investment in S Ltd at R240 000 (in J1) is, therefore, "over-eliminated" in order to determine the goodwill and to keep the amount for the goodwill constant as at the acquisition date. J6, therefore, subsequently corrects the over-elimination caused by J1.

Thus the following happens to the **investment in S Ltd** on consolidation:
 $184\ 000\ (\text{given}) - 240\ 000(J1) + 56\ 000(J6) = \text{Rnil}$.

- b J6 is the journal entry that deals with the buy-back of the shares. Note that the debit processed by P Ltd (R140 000) in its separate financial statements is not reversed, as the cash value received for the shares does not change due to consolidation. The cost of the shares bought back (per P Ltd's separate financial statements) is replaced by the **fair value** of the shares bought back (in the group), thereby accounting for the changes in ownership account in respect of the buy-back at the group level.

The credit side of the journal entry re-establishes the share capital and retained earnings due to the chronological order in which the journal entries take place (as explained previously).

Remember that S Ltd reduced (debited) the share capital and the retained earnings by means of an **actual** journal entry (as discussed above) in its individual financial statements. This leaves, for example, a share capital of R200 000 ($250\ 000 - 50\ 000 = \text{R}200\ 000$ as given in the statement of financial position of S Ltd) flowing into the consolidation. "At-acquisition" information (that cannot subsequently change because of the effect that such a change would have on goodwill/gain from a bargain purchase at acquisition) dictates that share capital of R250 000 be debited (refer to J1). Yet only R200 000 flowed into the consolidation from S Ltd. Thus, the share capital has been over-eliminated, and J6 must therefore be processed to correct this over-elimination.

Thus the following happens to the **share capital of S Ltd** on consolidation:
 $200\ 000\ (\text{given}) - 250\ 000(J1) + 50\ 000(J6) = \text{Rnil}$.

Other changes in ownership

14.4 Share-based payments of a subsidiary

In terms of a typical share-based payment transaction, a subsidiary may grant shares or options to its employees. When the new shares are issued to the employees, the total number of issued shares will increase, but the number of shares held by the parent will stay the same. This will lead to a decline in the parent's equity interest in the subsidiary, which should be accounted for by applying the same principles as illustrated previously. The parent would arguably not lose control through such a transaction as the parent having control would need to approve the share-based transaction.

Example 14.3	Issue of new shares by a subsidiary in terms of a share-based payment transaction resulting in a decrease of the interest of the parent (control is not lost) and the status does not change as the subsidiary remains a subsidiary (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)
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The following represents the abridged financial statements of P Ltd and its subsidiary S Ltd on 31 December 20.29:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29		
	P Ltd	S Ltd
ASSETS		
Inventory	434 000	415 000
Investment in S Ltd: 120 000 shares at cost	150 000	–
Total assets	R584 000	R415 000
EQUITY AND LIABILITIES		
Share capital (300 000/200 000 shares)	300 000	270 000
Retained earnings	284 000	145 000
Total equity and liabilities	R584 000	R415 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29		
	P Ltd	S Ltd
Revenue	500 000	300 000
Cost of sales	(300 000)	(200 000)
Gross profit	200 000	100 000
Other income (dividend received)	16 000	–
Profit before tax	216 000	100 000
Income tax expense	(80 000)	(40 000)
PROFIT FOR THE YEAR	136 000	60 000
Other comprehensive income for the year	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R136 000	R60 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29		
	Retained earnings	
	P Ltd	S Ltd
Balance at 1 January 20.29	164 000	105 000
Changes in equity for 20.29		
Total comprehensive income for the year:		
Profit for the year	136 000	60 000
Dividend paid: 31/5/20.29	(16 000)	(20 000)
Balance at 31 December 20.29	R284 000	R145 000

Additional information

- P Ltd acquired 120 000 shares in S Ltd on 1 January 20.27, when the equity of S Ltd consisted of the following:

Share capital (150 000 shares)	150 000
Retained earnings	30 000
	<u>R180 000</u>
- On 1 January 20.28, S Ltd granted options to its employees conditional upon one year's service. The vesting date was 31 December 20.28. The exercise price was set at R2.00 per share. On 31 December 20.28, 50 000 options vested and S Ltd recorded R20 000 in equity in terms of **IFRS 2 Share-based Payment**.
- On 30 June 20.29, the employees of S Ltd exercised all their options. S Ltd passed the following journal entry:

	Dr R	Cr R
Bank (SFP) (50 000 options × R2,00 each)	100 000	
Share-based payment reserve (transfer within equity)	20 000	
Share capital		120 000
Issue of shares after employees exercised their options		

- S Ltd's profit after tax for 20.29 accrued evenly.
- P Ltd accounted for the investment in S Ltd at cost in its separate financial statements.
- P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

Solution 14.3

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29	
ASSETS	
Non-current assets	
Goodwill (parent)	6 000
Current assets	
Inventory (434 000(P) + 415 000(S))	849 000
Total assets	R855 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	300 000
Retained earnings	370 000
Other components of equity (changes in ownership)	19 000
	689 000
Non-controlling interests	166 000
Total equity and liabilities	R855 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29	
Revenue (500 000(P) + 300 000(S))	800 000
Cost of sales (300 000(P) + 200 000(S))	(500 000)
Gross profit	300 000
Other income	—
Profit before tax	300 000
Income tax expense (80 000(P) + 40 000(S))	(120 000)
PROFIT FOR THE YEAR	180 000
Other comprehensive income	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R180 000
Profit attributable to:	
Owners of the parent	162 000
Non-controlling interests (6 000 + 12 000)	18 000
	R180 000
Total comprehensive income attributable to:	
Owners of the parent	162 000
Non-controlling interests (6 000 + 12 000)	18 000
	R180 000

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29						
	Share capital	Retained earnings	Changes in owner-ship	Total	Non-controlling interests	Total equity
Balance at 1 Jan 20.29	300 000	* 224 000	–	524 000	! 71 000	595 000
Changes in equity for 20.29						
Dividends	–	(16 000)	–	(16 000)	(4 000)	(20 000)
Total comprehensive income for the year:						
Profit for the year	–	162 000	–	162 000	18 000	180 000
Options exercised and new issue	–	–	19 000	19 000	\$ 81 000	100 000
Balance at 31 Dec 20.29	R300 000	# R370 000	R19 000	R689 000	R166 000	R855 000

* 164 000(P) + 60 000(S) = 224 000

! 36 000 + 15 000 + 20 000 = 71 000

284 000(P) + 86 000(S) = 370 000

\$ See J6

Calculations

C1 Analysis of the owners' equity of S Ltd

	Total	P Ltd 80%–60%		NCI
		At	Since	
i At acquisition (1/1/20.27)				
Share capital	150 000	120 000		30 000
Retained earnings	30 000	24 000		6 000
	180 000	144 000		36 000
Equity represented by goodwill – Parent	6 000	6 000		–
Consideration and NCI	186 000	150 000		36 000
ii Since acquisition				
• To beginning of current year:				
Retained earnings (105 000 – 30 000)	75 000		60 000	15 000
Share-based payment (comment (b))	20 000		–	20 000
• Current year:				
Profit: 1/1/20.29–30/6/20.29 (60 000 × 6/12)	30 000		24 000	6 000
Dividend paid: 31/5/20.29	(20 000)		(16 000)	(4 000)
	291 000		68 000	73 000
Options exercised (30/6/20.29)				
Shares issued	120 000			120 000
Equity transferred	(20 000)			(20 000)
Changes in ownership (equity) (comment (d) and (e))		19 000		(19 000)
	391 000		68 000	154 000
Profit: 1/7/20.29–31/12/20.29	30 000		18 000	12 000
	R421 000		R86 000	R166 000



Comments

- a P Ltd's percentage owners' equity in S Ltd can be calculated as follows:
- | | |
|---|-----|
| To 30/6/20.29 (120 000/150 000 shares in issue) | 80% |
| Since 1/7/20.29 (120 000/200 000 issued shares) | 60% |
- Consequently, there is no loss of control. However, there is a change in the ownership interest that should be recognised directly in equity in terms of IFRS 10.23.
- b S Ltd granted options to its employees in terms of the share-based payment transaction. These options (equity) are not held by the parent (P Ltd) and are, therefore, analysed in the column for the "non-controlling interests". These options represent other equity instruments held only by the employees (not the parent). Similar to the treatment of preference shares (refer to chapter 6 of this work), a separate analysis could have been prepared for these equity instruments.
- c The exact amount paid by P Ltd (Rnil) and the non-controlling shareholders for the shares taken up by them respectively is analysed in the "At" and "Non-controlling interest" columns. This approach then resembles the pro forma consolidation journal entry (see J6) to account for the issue of shares and any change in ownership – see below.
- d The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (**from the perspective of the NCI**):
- | | |
|--|------------------|
| Fair value of the consideration paid by NCI for new shares issued to them
(R100 000 cash) | (100 000) |
| Amount by which the non-controlling interests are adjusted | 81 000 |
| NCI after transaction $((391\ 000 - 6\ 000\text{GW}) \times 40\%)$ | 154 000 |
| NCI before transaction $((291\ 000 - 6\ 000\text{GW} - 20\ 000) \times 20\% + (20\ 000\text{ share-based payment}))$ | (73 000) |
| Amount to be recognised directly in equity | <u>(R19 000)</u> |
- e The amount for the change in ownership recognised in equity can also be calculated as follows (**from the perspective of the parent**):
- | | |
|---|----------------|
| Fair value of the consideration paid by the parent for new shares issued | – |
| Increase in P Ltd owners' equity through new issue: | 19 000 |
| Owners' equity held by P Ltd after issue
$((391\ 000 - 6\ 000\text{GW}) \times 60\%) + 6\ 000\text{GW}$ | 237 000 |
| Owners' equity held by P Ltd before issue
$((291\ 000 - 6\ 000\text{GW} - 20\ 000) \times 80\%) + 6\ 000\text{GW}$ | (218 000) |
| Amount to be recognised directly in equity | <u>R19 000</u> |

C1.1 Alternative approach for analysis

	Total	P Ltd 80%–60%		NCI
		At	Since	
Owner's equity before share issue	291 000		68 000	73 000
Options exercised (30/6/20.29)				
Equity transferred	(20 000)			(20 000)
Changes in ownership:				
– Equity relinquished (1)		(36 000)	(17 000)	53 000
– Compensation by sharing in new equity (2)	120 000	55 000	17 000	48 000
	391 000	19 000		
Changes in ownership (equity) (see comment below)		(19 000)		
Consideration and NCI		–		R154 000

(1) $144\,000 \times 20/80 = 36\,000$; $68\,000 \times 20/80 = 17\,000$

(2) $120\,000 \times 60\%$ (thus new ownership interest) = 72 000; allocated 55 000 and 17 000

Although the parent did not take up any shares, it is nonetheless still entitled to a portion of the new equity because of its existing ownership interest in the ratio of ownership interest **after** the issue of the new shares (i.e. 60:40). This “bonus” serves as compensation for the equity lost (ceded) to the non-controlling interests.



Comment

A gain (R19 000) results from the parent's new ownership interest, as the parent's new attributable equity (R72 000) is higher than the equity ceded to the non-controlling interests (R36 000 + R17 000 = R53 000). This gain is to be treated in terms of IFRS 10.23 – i.e. taken directly to equity, as the parent (P Ltd) does not relinquish control over S Ltd. Although P Ltd's interest decreased from 80% to 60%, its actual ownership interest increased by R19 000.

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	150 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	36 000
	<u>186 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(180 000)
Goodwill (parent)	<u>R6 000</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) (parent) Non-controlling interests (SCE) Investment in S Ltd (SFP) Main elimination journal entry	150 000 30 000 6 000	36 000 150 000
J2	Retained earnings – Beginning of year (SCE) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of retained earnings	15 000	15 000
J3	Share-based payment reserve – Beginning of year (SCE) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of the share-based payment recognised in equity	20 000	20 000
J4	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit before options exercised	6 000	6 000
J5	Dividend received (P/L) Non-controlling interests (SCE) Dividend paid (SCE) Elimination of intragroup dividend	16 000 4 000	20 000
J6	Share capital (SCE) Share-based payment reserve (transfer within equity) (SCE) Non-controlling interests (SCE) (120 000 – 20 000 – 19 000) Changes in ownership (equity) (SCE) Elimination of option exercised and new shares issued, resulting in a change in ownership interest	120 000	20 000 81 000 19 000
J7	Non-controlling interests (P/L) Non-controlling interests (SCE) Allocation of non-controlling interests' portion of current year's profit after the new issue	12 000	12 000

14.5 Obtaining control through an agreement and loss of control through expiry of an agreement

There may be various circumstances in which a parent may **control** a subsidiary in terms of IFRS 10. Control can, for example, exist when the parent owns half or less of the voting power of an entity but enjoys power over more than half of the voting rights by virtue of an agreement with other investors (IFRS 10.11) (also see chapter 10 for a detailed discussion of “control”). IFRS 3.43–.44 also stipulates that a business combination (gaining control) can be effected without the transfer of any consideration and/or by virtue of an agreement.

A parent may **lose control** of a subsidiary with or without a change in absolute or relative ownership levels. Loss of control can result from the sale of an ownership interest to other parties (see chapter 13) or by other means, such as when a subsidiary, for example, issues new shares to other parties (see previous sections of this chapter). Loss of control can also occur in the absence of a transaction. It may, for example, occur on the expiry of an agreement that previously allowed an entity to control a subsidiary (also see IFRS 10.BCZ180).

Example 14.4	Obtaining control through an agreement where an associate becomes a subsidiary (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)
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On 31 December 20.22, the following summarised financial information relating to P Ltd and other subsidiaries (consolidated) and S Ltd is supplied:

SUMMARISED FINANCIAL INFORMATION AS AT 31 DECEMBER 20.22		
	P Ltd and sub-sidiaries (consoli-dated)	S Ltd
DEBITS		
Property, plant and equipment	57 500	9 000
Investment in S Ltd at cost:		
8 000 shares purchased on 1/1/20.20 (consideration)	8 000	—
Inventory	144 500	31 000
Cost of sales (*)	8 000	3 000
Income tax expense (*)	2 000	1 000
	R220 000	R44 000
CREDITS		
Share capital (150 000/20 000 shares)	150 000	20 000
Retained earnings: 1/1/20.22	50 000	5 000
Sundry liabilities (including deferred tax)	—	9 000
Revenue (*)	20 000	10 000
	R220 000	R44 000

(*) Accrued/incurred evenly

Additional information

- 1 P Ltd acquired 8 000 shares in S Ltd at the incorporation of S Ltd on 1 January 20.20. On 30 April 20.22, P Ltd signed an agreement with one of the other shareholders whereby P Ltd can exercise another 30% of the voting rights at a meeting. P Ltd is not an agent of the other shareholder and does not act on his behalf. P Ltd thereby obtained control of S Ltd in terms of IFRS 10.

- 2 At the acquisition date (i.e. the date on which P Ltd obtained **control** of S Ltd), the assets and liabilities of S Ltd were regarded as a fair reflection in terms of the requirements of IFRS 3, except for land for which the fair value was R542 more than its carrying amount. The acquisition-date fair value of P Ltd's previously held equity interest was R11 100.
- 3 P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date.
- 4 P Ltd accounts for all investments in associates in accordance with the equity method in its **consolidated financial statements**, as none of the exceptions in IAS 28.13 applies.
- 5 P Ltd measures the investment in S Ltd at cost in its separate financial statements.
- 6 The company tax rate is 27% and CGT is calculated at 80% thereof.

Solution 14.4

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.22	
ASSETS	
Non-current assets	
Property, plant and equipment (57 500(P) + 9 000(S) + 542 (J4))	67 042
Goodwill (parent)	130
	67 172
Current assets	
Inventory (144 500(P) + 31 000(S))	175 500
Total assets	R242 672
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	150 000
Retained earnings	64 700
	214 700
Non-controlling interests (S)	18 855
Total equity	233 555
Liabilities (9 000(S) + 117 (J4))	9 117
Total equity and liabilities	R242 672

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.22	
Revenue (20 000(P) + 10 000(S) – 3 333(J5))	26 667
Cost of sales (8 000(P) + 3 000(S) – 1 000(J5))	(10 000)
Gross profit	16 667
Other income (remeasurement gain) (J3)	300
Share of profit of associate (J2)	800
Profit before tax	17 767
Income tax expense (2 000(P) + 1 000(S) – 333(J5))	(2 667)
PROFIT FOR THE YEAR	15 100
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R15 100
Profit attributable to:	
Owners of the parent	12 700
Non-controlling interests (last eight months of current period) (J6)	2 400
	R15 100
Total comprehensive income attributable to:	
Owners of the parent	12 700
Non-controlling interests (last eight months of current period) (J6)	2 400
	R15 100

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.22					
	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 January 20.22	150 000	* 52 000	202 000	–	202 000
Changes in equity for 20.22					
Acquisition of subsidiary	–	–	–	16 455	16 455
Total comprehensive income for the year:					
Profit for the year	–	12 700	12 700	2 400	15 100
Balance at 31 December 20.22	R150 000	R64 700	R214 700	R18 855	R233 555

* 50 000(P) + 2 000(S) = 52 000

Calculations**C1.1 Analysis of the owners' equity of S Ltd – as associate**

	Total	P Ltd 40%		NCI
		At	Since	
i Date of first purchase				
Share capital	20 000	8 000		n/a
Retained earnings	–	–		
	20 000	8 000		n/a
Consideration		8 000		
ii Since date of first purchase				
• To beginning of current year: Retained earnings (5 000 – 0)	5 000		2 000	n/a
• Current year: Profit: 1/1/20.22–30/4/20.22 (6 000 × 4/12 = 2 000(accrued evenly))	2 000		800	n/a
	27 000		2 800	n/a
Associate becomes a subsidiary				
Derecognise associate	(27 000)	(8 000)	(2 800)	n/a
	–	–	–	–

C1.2 Analysis of the owners' equity of S Ltd – as subsidiary

	Total	P Ltd 40%		NCI
		At	Since	
i At acquisition (30 April 20.22)				
Share capital	20 000	8 000		12 000
Retained earnings at beginning of year	5 000	2 000		3 000
Profit for current year before acquisition	2 000	800		1 200
Revaluation surplus (542 × 78,4%)	425	170		255
Total equity acquired	27 425	10 970		16 455
Equity represented by goodwill – Parent	130	130		–
Consideration and NCI	27 555	11 100		16 455
ii Since acquisition				
Profit: 1/5/20.22–31/12/20.22 (6 000 × 8/12 = 4 000(accrued evenly))	4 000		1 600	2 400
	R31 555		R1 600	R18 855

	Comments a The retained earnings at acquisition of S Ltd as a subsidiary comprises the balance at the beginning of the year and the net profit for the first four months up to the date of the business combination. Refer to chapter 8 for more details on the “interim acquisitions” of a subsidiary. b This is a business combination (obtained control through an agreement) in which no consideration was transferred (IFRS 3.33 and B46). The consideration for the business combination is therefore replaced by the fair value of the equity interest previously held. In terms of IFRS 3.42, P Ltd should remeasure its equity interest previously held (i.e. investment in associate) to the fair value of R11 100 at the date of acquisition. Note that the carrying amount of the investment in S Ltd (previously held equity interest) at the acquisition date (in the consolidated financial statements) is R10 800 (i.e. R8 000 (cost) + R2 000 (share in retained earnings) + R800 (current-period share of profit of associate)). The investment is remeasured to R11 100, and a remeasurement gain of R300 (11 100 – 10 800) is recognised in the consolidated financial statements – refer to journal 3 below.
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C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i) now replaced by the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree:	11 100
Amount of non-controlling interests: IFRS 3.32(a)(ii)	16 455
	27 555
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(27 425)
Goodwill (parent)	R130

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in S Ltd (associate) (SFP) (comment (a)) Retained earnings (SCE) Accounting for investor's interest in reserves of associate at beginning of current year	2 000	2 000
J2	Investment in S Ltd (associate) (SFP) (comment (a)) Share of profits of associate (P/L) Accounting for investor's share of current year's profit (1/1/20.22–30/4/20.22, i.e. before the business combination) of associate	800	800
J3	Investment in S Ltd (associate) (SFP) (comment (b)) Other income (remeasurement gain) (P/L) Accounting for remeasurement gain on equity interest previously held	300	300

continued

		Dr R	Cr R
J4	Land (SFP) Equity at acquisition ($542 \times 78,4\%$) Deferred tax ($542 \times 80\% \times 27\%$) Revaluation of land to the acquisition date fair value	542	425 117
J5	Share capital (SCE) Retained earnings: opening balance (SCE) (comment (c)) Equity at acquisition Goodwill (SFP) (parent) Revenue (P/L) (comment (c)) ($10\,000 \times 4/12$) Cost of sales (P/L) (comment (c)) ($3\,000 \times 4/12$) Income tax expense (P/L) (comment (c)) ($1\,000 \times 4/12$) Investment in S Ltd (SFP) (now subsidiary) ($8\,000 + 2\,000 + 800 + 300$) Non-controlling interests (SCE) Main elimination journal entry at acquisition date	20 000 5 000 425 130 3 333 	1 000 333 11 100 16 455
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Non-controlling interests' portion of current year's profit (1/5/20.22–31/12/20.22, i.e. after the business combination)	2 400	2 400



Comments

- a Journal 1 and 2 are typical journal entries for the accounting of associates in terms of the equity method (see chapter 11 for detail).
- b Journal 3 represents the adjustment of the equity interest previously held to fair value, with the recognition of the remeasurement gain in the consolidated financial statements in terms of IFRS 3.42.
- c To prepare the consolidated financial statements, the financial statements of S Ltd are combined (consolidated) with the financial statement of P Ltd (i.e. adding every line item in the financial statement of S Ltd to those of P Ltd). This implies that the whole amount (i.e. for the full year) of all items of profit or loss is added to that of P Ltd. S Ltd was not a subsidiary of P Ltd for the first four months, and the profit earned during those four months should not form part of the profit or loss for the group and should be eliminated from the group's profit or loss. The profits for the first four months are actually part of the reserves at the acquisition date and should be eliminated as such in accounting for the business combination.

Example 14.5	Loss of control over a subsidiary on expiry of agreement (NCI is measured at fair value at the acquisition date)
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P Ltd had control over S Ltd through an agreement with other shareholders. The following represents the abridged financial statements of P Ltd and its subsidiary S Ltd on 31 December 20.29:

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29		
	P Ltd	S Ltd
ASSETS		
Inventory	725 000	300 000
Investment in S Ltd: 30 000 shares at cost	55 000	—
Total assets	R780 000	R300 000
EQUITY AND LIABILITIES		
Share capital (300 000/100 000 shares)	300 000	100 000
Retained earnings	480 000	200 000
Total equity and liabilities	R780 000	R300 000

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29		
	P Ltd	S Ltd
Revenue	600 000	400 000
Cost of sales	(250 000)	(300 000)
Profit before tax	350 000	100 000
Income tax expense	(170 000)	(50 000)
PROFIT FOR THE YEAR	180 000	50 000
Other comprehensive income for the year	—	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R180 000	R50 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29		
	Retained earnings	
	P Ltd	S Ltd
Balance at 1 January 20.29	300 000	150 000
Changes in equity for 20.29		
Total comprehensive income for the year:		
Profit for the year	180 000	50 000
Balance at 31 December 20.29	R480 000	R200 000

Additional information

- 1 P Ltd acquired 30 000 shares in S Ltd on 1 January 20.27, when the equity of S Ltd consisted of the following:

Share capital	100 000
Retained earnings	80 000
	R180 000
- 2 P Ltd accounted for the investment in S Ltd at cost in its separate financial statements.
- 3 P Ltd elected to measure the non-controlling interests at their fair value at the acquisition date. The fair value of the non-controlling interests at the acquisition date was R130 000.
- 4 On 1 January 20.27, P Ltd signed an agreement with one of the other shareholders (with 25% interest) whereby P Ltd became entitled to control its vote at a shareholders' meeting. P Ltd was not an agent of the other shareholder and did not act on his behalf. P Ltd thus gained control over S Ltd as P Ltd has 55% of the voting rights.
- 5 This agreement expired on 31 December 20.29. From this date, P Ltd no longer enjoyed control over S Ltd. The fair value of the investment by P Ltd in S Ltd was R95 000 at the date when control was lost. After 31 December 20.29, P Ltd accounts for its investment in S Ltd as an associate.
- 6 The company tax rate is 27% and CGT is calculated at 80% thereof.

Solution 14.5

The consolidated financial statements of P Ltd and its subsidiary S Ltd are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.29	
ASSETS	
Non-current assets	
Goodwill	—
Investment in associate (55 000(cost) + 40 000(J1))	95 000
	95 000
Current assets	
Inventory (725 000(P))	725 000
Total assets	R820 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	300 000
Retained earnings	520 000
Non-controlling interests	—
Total equity and liabilities	R820 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.29	
Revenue (600 000(P) + 400 000(S))	1 000 000
Cost of sales (250 000(P) + 300 000(S))	(550 000)
Gross profit	450 000
Other income (gain on the loss of control)	4 000
Share of profit of associate	–
Profit before tax	454 000
Income tax expense (170 000(P) + 50 000(S))	(220 000)
PROFIT FOR THE YEAR	234 000
Other comprehensive income	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R234 000
Profit attributable to:	
Owners of the parent	199 000
Non-controlling interests	35 000
	R234 000
Total comprehensive income attributable to:	
Owners of the parent	199 000
Non-controlling interests	35 000
	R234 000

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.29					
	Share capital	Retained earnings	Total	Non-control- ling interests	Total equity
Balance at 1 January 20.29	300 000	* 321 000	621 000	179 000	800 000
Changes in equity for 20.29					
Total comprehensive income for the year:					
Profit for the year	–	199 000	199 000	35 000	234 000
Control over subsidiary lost	–	–	–	(214 000)	(214 000)
Balance at 31 December 20.29	R300 000	# R520 000	R820 000	–	R820 000

* 300 000(P) + 21 000(S) = 321 000

Test: 480 000(P) + 40 000(S) = 520 000

Calculations

C1.1 Analysis of the owners' equity of S Ltd – as subsidiary

	Total	P Ltd 30%		NCI
		At	Since	
i At acquisition (1/1/20.27)				
Share capital	100 000	30 000		70 000
Retained earnings	80 000	24 000		56 000
	180 000	54 000		126 000
Equity represented by goodwill – Parent and NCI	5 000	1 000		4 000
Consideration and NCI	185 000	55 000		130 000
ii Since acquisition				
• To beginning of current year: Retained earnings (150 000 – 80 000)	70 000		21 000	49 000
• Current year: Profit	50 000		15 000	35 000
	305 000		36 000	214 000
Loss of control over subsidiary: Derecognition of assets (including goodwill), liabilities and NCI (IFRS 10.B98(a))	(305 000)	(55 000)	(36 000)	(214 000)
	–	–	–	–

C1.2 Analysis of the owners' equity of A Ltd – as associate

	Total	P Ltd 30%		NCI
		At	Since	
i At acquisition				
Recognise remaining interest at fair value	316 667	95 000		n/a

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	55 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	130 000
	<u>185 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	<u>(180 000)</u>
Goodwill (parent and NCI)	<u>R5 000</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in S Ltd (SFP) (95 000 fair value – cost of R55 000 in separate financial statements of P Ltd) Gain on disposal of interest (P)(P/L) Retained earnings – Beginning of year (SCE) Revenue (P/L) (comment (a)) Cost of sales (P/L) (comment (a)) Income tax expense (P/L) (comment (a)) Non-controlling interests (P/L) (full year) (comment (a)) Gain on disposal of interest (group context) (P/L) Gain on disposal of interest (group context) (P/L) (Remeasurement gain) (IFRS 10.25)) Consolidation of subsidiary for the full year and recognition of the loss of control	40 000 – 300 000 50 000 35 000	 21 000 400 000 – 4 000
J2	Non-controlling interests (SCE) (derecognised) Non-controlling interests (SCE) (opening balance in equity) (130 000 + 49 000) Non-controlling interests (SCE) (Current year's interest in profit) Accounting for various line items of non-controlling interests in equity for S Ltd	214 000	 179 000 35 000

	Comments											
	a Note that S Ltd was a subsidiary of P Ltd for the full year. Since S Ltd was not a subsidiary of P Ltd at the reporting date, S Ltd's separate financial statements will not be combined with those of the parent (P Ltd) as a starting point for consolidation. This means that the results for S Ltd would have to be journalised into the consolidation, as is seen in the pro forma consolidation journal entry above. b Even though P Ltd did not dispose of any shares in S Ltd, it lost control over S Ltd through the expiry of the agreement by which P Ltd controlled S Ltd. The gain or loss on the disposal of the interest would be calculated as follows, using IFRS 10.B98: <table> <tr> <td>Derecognise assets (including goodwill) and liabilities on the date control is lost (300 000 other net assets + 5 000 goodwill) (IFRS 10.B98(a))</td> <td>(305 000)</td> </tr> <tr> <td>Derecognise non-controlling interests (IFRS 10.B98(a))</td> <td>214 000</td> </tr> <tr> <td>Net asset value attributable to parent derecognised</td> <td>(91 000)</td> </tr> <tr> <td>Fair value of consideration received recognised (i.e. cash received) (IFRS 10.B98(b))</td> <td>–</td> </tr> <tr> <td>Recognise fair value of investment in former subsidiary retained (IFRS 10.B98(b))</td> <td>95 000</td> </tr> <tr> <td>Net gain on disposal of interest (group context) (IFRS 10.B98(d)) attributable to the owners of the parent</td> <td><u>R4 000</u></td> </tr> </table> The amount of R4 000 only comprises the fair value remeasurement of the retained interest, because P Ltd did not dispose of any shares in S Ltd	Derecognise assets (including goodwill) and liabilities on the date control is lost (300 000 other net assets + 5 000 goodwill) (IFRS 10.B98(a))	(305 000)	Derecognise non-controlling interests (IFRS 10.B98(a))	214 000	Net asset value attributable to parent derecognised	(91 000)	Fair value of consideration received recognised (i.e. cash received) (IFRS 10.B98(b))	–	Recognise fair value of investment in former subsidiary retained (IFRS 10.B98(b))	95 000	Net gain on disposal of interest (group context) (IFRS 10.B98(d)) attributable to the owners of the parent
Derecognise assets (including goodwill) and liabilities on the date control is lost (300 000 other net assets + 5 000 goodwill) (IFRS 10.B98(a))	(305 000)											
Derecognise non-controlling interests (IFRS 10.B98(a))	214 000											
Net asset value attributable to parent derecognised	(91 000)											
Fair value of consideration received recognised (i.e. cash received) (IFRS 10.B98(b))	–											
Recognise fair value of investment in former subsidiary retained (IFRS 10.B98(b))	95 000											
Net gain on disposal of interest (group context) (IFRS 10.B98(d)) attributable to the owners of the parent	<u>R4 000</u>											

continued

c	Remeasurement of investment retained in terms of IFRS 10.25:	
	Fair value of retained 30% investment in former subsidiary (given) (IFRS 10.25(b))	95 000
	Carrying amount of retained 30% investment in the former subsidiary (55 000 + 36 000) (analysis))	(91 000)
		<u>R4 000</u>
Remeasurement (gain) to be recognised in profit or loss (refer to J1)		
d	To obtain continuity between the amounts of the current and previous periods' consolidated statements of profit or loss and other comprehensive income, the gain of R0 (per the separate financial statements of the parent) is included in the current period's consolidated statement of profit or loss and other comprehensive income and the consolidated statement of changes in equity, as follows:	
	Included in opening consolidated retained earnings at the beginning of the period	21 000
	Included in profit for the current period (*) as various line items	15 000
		<u>36 000</u>
	Group's net gain in the consolidated statement of profit or loss and other comprehensive income (comment (b) above)	4 000
	Adjustment of carrying amount of the investment to fair value	<u>(40 000)</u>
	Gain on disposal of interest per separate records of P Ltd	<u>Rnil</u>
This approach is also evident from J1 above, where the investment in S Ltd is increased with R40 000 (fair value of R95 000 less cost price of R55 000 still contained in the separate financial statements of P Ltd), the amount profit according to P Ltd is reversed (Rnil in this example) and replaced by the parent's portion of the retained earnings at the beginning of the period, the various line items in profit or loss and the group's profit on the loss of control over the subsidiary.		
e	The R15 000(*) is taken up in the consolidated statement of profit or loss and other comprehensive income by adding R50 000 to the profit of the group, and by adding (thereafter) R35 000 to the non-controlling interests.	

14.6 Accounting for a change in investment entity status

An investment entity (as defined) (see paragraph 10.2) may have control over another entity but is excluded from the requirement to prepare consolidated financial statements. Instead, the investment in a subsidiary will be measured at fair value through profit or loss. A change in the status of an investment entity should be accounted for as follows:

1 An entity ceases to be an investment entity

When an entity ceases to be an investment entity, it shall follow the same principles as were discussed previously in this and the preceding chapter:

- ☐ apply IFRS 3 to any subsidiary that was previously measured at fair value through profit or loss (i.e. account for it as a **business combination**);
- ☐ the date of the change of status shall be the deemed acquisition date;
- ☐ the previously held interest shall be deemed disposed of;
- ☐ use the fair value of the subsidiary at the deemed acquisition date as the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition; and
- ☐ consolidate the subsidiary from the date of the change of status.

2 An entity becomes an investment entity

When an entity becomes an investment entity, it shall again follow the same principles as were discussed previously:

- ☐ it shall cease to consolidate its subsidiaries at the date of the change in status; and
- ☐ account for the **loss of control** of those subsidiaries at that date.

Changes in associates and joint ventures

14.7 Accounting for other changes in the net assets of an associate

The current version of IAS 28 **Investments in Associates and Joint Ventures** does not specifically address **other changes in the net assets** of an investee (e.g. issuing of new shares). The standard only stipulates the treatment of items in profit or loss, and other comprehensive income of the associate or joint venture under the equity method.

In June 2022, the IASB was still busy with its “Equity Method Project” (refer to IASB Update June 2022), and no final decision was made at the time this publication was finalised. The IASB is specifically considering the accounting treatment for:

- ☐ Purchase of an additional interest and disposal of an interest in an associate, while retaining significant influence; and
- ☐ Other changes in an associate's net assets (rights issues, buy-back of shares, share issues under share-based payments, etc., may arguably fall under such other changes).

IFRS 5 and investments held for sale

The preceding chapters ignored the implication of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** on the sale of an interest in a subsidiary or associate/joint venture. This section does not aim to provide a comprehensive overview of the principles contained within IFRS 5, but only those sections from IFRS 5 that directly impact the preparation of **consolidated financial statements** will be addressed. It is recommended that IFRS 5 be consulted directly in conjunction with this section of the work.

14.8 Important definitions

Disposal group

A disposal group is a group of assets (both non-current and current) to be disposed of by sale or otherwise, together as a group in a single transaction. The liabilities associated with those assets will be included in the transaction. The disposal group will include goodwill acquired in a business combination if the group is a **cash-generating unit** to which goodwill has been allocated. A disposal group can also be an operation within a cash-generating unit with or without goodwill acquired.

Discontinued operation

A discontinued operation **is a component of an entity** that either has been disposed of, or is classified as held for sale and:

- ☐ represents a separate major line of business or geographical area of operations; and

- ☐ is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- ☐ is a subsidiary acquired exclusively with a view to resale.

14.9 Applying IFRS 5 in the consolidated financial statements

A subsidiary held for sale refers to a situation where the parent is planning to dispose of its **interest** in the subsidiary (i.e. selling the investment) but not by disposing of the individual assets and liabilities of that subsidiary. Subsidiaries held for sale shall still be included in the consolidated financial statements of the parent and are not exempt from consolidation. A parent that is committed to a sale plan involving **loss of control of a subsidiary** shall **classify** that subsidiary as **held for sale** when the criteria set out in IFRS 5 are met, even if the parent will retain a non-controlling interest in its former subsidiary after the sale.

The effect of IFRS 5 is that the subsidiary held for sale is still consolidated in the consolidated financial statements, but the assets and liabilities of the subsidiary are classified as a **disposal group** that is held for sale and are **presented separately** in the consolidated financial statements.

1 Subsidiaries classified as held for sale subsequent to the acquisition date

The classification of a subsidiary as held for sale subsequent to the acquisition date has the following implications for the consolidation process:

- ☐ The assets of the subsidiary will not be classified as held for sale in the **individual financial statements** of the subsidiary, as it is not the subsidiary that is planning to sell its assets; it is the parent that plans to sell its **interest in the subsidiary** whereby control over the subsidiary will be lost. The subsidiary (in its individual financial statements) will keep on accounting for its assets and liabilities under the relevant accounting standards, ignoring IFRS 5 (i.e. depreciate the items of property, plant and equipment and measure deferred tax with reference to the tax consequences flowing from using the assets).
- ☐ The parent will classify its **investment in the subsidiary** (in the separate financial statements of the parent) as held for sale. If the parent kept the investment at cost, it should now be measured in accordance with IFRS 5 at the lower of the carrying amount of the investment and the fair value less costs to sell. If the parent accounted for the investment in accordance with IFRS 9, the measurement would not change as such investments are scoped out from the measurement provisions of IFRS 5 (see IFRS 5.5(c)).
- ☐ Any **adjustments** to the carrying amount of the non-current asset held for sale (i.e. the investment) in the parent's separate financial statements (impairment or fair value adjustments) will need to be reversed upon consolidation so that the investment is at the amount of initial recognition before the consolidation process can begin.
- ☐ The **deferred tax balance** relating to the investment in the subsidiary held for sale should reflect the tax consequences from **selling** the investment in the subsidiary. The tax consequence for the parent would normally be the capital gain or loss on disposing of the shares (investment) in the subsidiary at its carrying amount. Deferred tax should therefore be measured at the effective capital gains tax rate (currently $80\% \times 27\%$). It should be borne in mind that the individual assets of the

subsidiary will not be sold, and there is no need to change the measurement of the deferred tax on the individual assets and liabilities in the **individual** financial statements of the **subsidiary** itself.

- The subsidiary would continue to recognise **depreciation or amortisation** on specific assets in its individual financial statements (as explained above). For consolidation purposes, any depreciation or amortisation recognised by the subsidiary after the interest in the subsidiary was classified as held for sale (in the consolidated financial statements) should be reversed as the group has classified the assets as held for sale.
- The assets, liabilities and any amount previously recognised in other comprehensive income of the subsidiary held for sale, should be **presented separately as held for sale** in the consolidated statement of financial position (this implies that the assets, liabilities and items of other comprehensive income of the subsidiary should not be consolidated on a line-by-line basis; the consolidation may perhaps be described as a three-line consolidation).
- The assets and liabilities of the subsidiary would be the disposal group held for sale, and the **disposal group** must be measured at the lower of the consolidated carrying amount and the fair value less costs to sell.
- The group may need to recognise an **impairment loss** (in profit or loss) in measuring the disposal group at fair value less costs to sell. The impairment loss should first be allocated against any goodwill recognised in respect of this subsidiary and thereafter allocated to other assets measured according to IFRS 5 (refer to IFRS 5.23 and IAS 36.104). This allocation to the various assets is needed as IFRS 5 requires disclosure of the major classes of assets classified as held for sale. The impairment of any goodwill may need to be allocated between the parent and the non-controlling interests in terms of Appendix C of IAS 36.

2 Subsidiaries acquired exclusively with a view to resale

A subsidiary acquired exclusively with a view to resale would immediately meet the definition of a discontinued operation in terms of IFRS 5, and the results of the subsidiary will be presented as a discontinued operation line item in the statement of profit or loss and other comprehensive income. By nature, all the assets and liabilities of the subsidiary will be classified as held for sale.

The classification of a subsidiary as acquired exclusively with a view to resale at the acquisition date has the following implications on the consolidation process:

- The assets of the subsidiary will not be classified as held for sale in the **individual financial statements** of the subsidiary, as it is not the subsidiary that is planning to sell its assets; it is the parent that plans to sell its **interest in the subsidiary** whereby control over the subsidiary will be lost. The subsidiary (in its individual financial statements) will keep on accounting for its assets and liabilities under the relevant accounting standards, ignoring IFRS 5 (i.e. depreciate the items of property, plant and equipment and measure deferred tax with reference to the tax consequences flowing from using the assets).
- The parent will classify its investment in the subsidiary (in the separate financial statements of the parent) as a non-current asset held for sale on the acquisition date. The investment will be measured on initial recognition at the lower of its carrying amount had it not been so classified (e.g., cost) and fair value less costs to sell. Accordingly, it shall be measured at fair value less costs to sell. The parent's intention is to sell the shares of the subsidiary. Therefore, the fair value

less cost to sell referred to on initial recognition refers to the fair value less cost to sell the shares and not to that of all the individual net assets. This could result in an impairment recognised on initial recognition.

- ❑ Any subsequent adjustments to the carrying amount of the non-current asset held for sale (i.e. the share investment) in the parent's separate financial statements (impairment or fair value adjustments) will need to be reversed upon consolidation so that the investment is at the amount of initial recognition before the consolidation process can begin.
- ❑ In the consolidated financials, the disposal group (i.e. the subsidiary as a whole with all its assets and liabilities) is measured as fair value less cost to sell on the acquisition date, with reference to the fair value of the subsidiary's shares. This value is compared to the net asset value of the subsidiary, and any impairment is recognised in the subsidiary's retained earnings (at acquisition) and the assets of the disposal group held for sale.
- ❑ The normal consolidation procedures should then be followed whereby all the line items of the subsidiary are added to that of the parent.
- ❑ The liabilities of the subsidiary are measured in terms of their respective standards and transferred to liabilities directly associated with the assets of the disposal group held for sale. Next, the assets of the subsidiary will be transferred to the assets of the disposal group held for sale.
- ❑ At the reporting date, the disposal group held for sale must be remeasured to the lower of the consolidated carrying amount and the fair value less costs to sell the subsidiary's shares.
- ❑ The subsidiary would continue to recognise depreciation or amortisation on specific assets in its individual financial statements (as explained above). For consolidation purposes, any depreciation or amortisation recognised by the subsidiary should be reversed as the group has classified the assets as held for sale.
- ❑ The results (profit or loss) of the subsidiary will be presented as a **discontinued operation** in the statement of profit or loss and other comprehensive income. This line item will be made up of the profit after tax of the subsidiary as well as any subsequent impairment recognised in the consolidated financial statements. All profit or loss line items will be transferred to the profit/loss for the period from discontinued operations.

14.10 Associates classified as held for sale

If an entity decides to sell an investment in an associate, or a portion of an investment, and it meets the criteria contained in IFRS 5, the investment becomes a non-current asset held for sale, and is accounted for in accordance with **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** (IAS 28.20).

Any **retained portion** of an investment in an associate that has not been classified as held for sale should be accounted for using the equity method (until the disposal of the portion that was classified as held for sale). After the disposal takes place, the retained portion of the investment should be accounted for in accordance with **IFRS 9 Financial Instruments** unless the retained investment continues to be an associate, in which case the equity method should be used.

In instances where the investment in the associate no longer complies with the criteria for classification as held for sale, the equity method is applied, and the financial statements are adjusted retrospectively as if the investment had never been carried as held for sale (IAS 28.21).

15

Foreign operations

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Introduction

An entity may carry on foreign activities in two ways. It may have individual transactions in foreign currencies, or it may have foreign operations. In addition, an entity may also decide to present its financial statements in a foreign presentation currency.

IAS 21 The Effects of Changes in Foreign Exchange Rates prescribes how to include individual foreign currency transactions, as well as the financial results of foreign operations, in the financial statements of an entity. The standard also prescribes the translation of a set of financial statements into a presentation currency other than its functional currency. This chapter focuses on the following two aspects of IAS 21:

- ☐ how to include the financial results of foreign operations in the financial statements of the reporting entity; and
- ☐ how to translate financial statements into a presentation currency.

Important definitions

15.1 Foreign operations

IAS 21.08 defines a **foreign operation** as an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity. Many South African undertakings have branches, subsidiaries, associates and/or joint arrangements in other countries.

It is also important to note that a foreign operation is not only an entity that is situated in a country other than the country of the reporting entity. It is clear from the definition that a foreign operation is either:

- ☐ an entity that conducts its activities in a country other than the country of the reporting entity; or
- ☐ conducts its activities in a currency other than the currency of the reporting entity.

This could therefore result in a scenario where a South African reporting entity has a foreign operation that is situated in South Africa and has a functional currency different from that of the reporting entity. The term “functional currency” is defined below.

15.2 Functional currency

IAS 21.08 defines a **functional currency** as the currency of the primary economic environment in which the entity operates. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash.

According to IAS 21.09, an entity considers the following primary factors when determining its functional currency:

- ☐ the currency that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated (quoted) and settled);
- ☐ the currency of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services; and

- ☐ the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

According to IAS 21.10, the following factors may also provide evidence of an entity's functional currency:

- ☐ the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; or
- ☐ the currency in which receipts from operating activities are usually retained.

According to IAS 21.11, the following additional factors are considered when determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity in this context is the entity that has the foreign operation as its subsidiary, branch, associate or joint arrangement):

- ☐ whether the activities of the foreign operation are carried out as an extension of the reporting entity's activities, rather than being carried out with a significant degree of autonomy (independence). An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency;
- ☐ whether transactions with the reporting entity constitute a high or a low proportion of the foreign operation's activities;
- ☐ whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it; and
- ☐ whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

When the above indicators give a mixed result, and the functional currency is not obvious, management uses its **judgement** to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. Management gives priority to the primary indicators in IAS 21.09 before considering the indicators in IAS 21.10 and IAS 21.11, which are designed to provide additional supporting evidence to determine an entity's functional currency.

An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

The functional currency of an entity is **not a free choice** and must be carefully determined.

15.3 Presentation currency

IAS 21.08 defines **presentation currency** as the currency in which the financial statements are presented.

The presentation currency of an entity **is a free choice**, in contrast to the functional currency (as indicated above).

15.4 Spot exchange rate

The **spot exchange rate** is the exchange rate for immediate delivery.

15.5 Closing rate

The **closing rate** is the spot exchange rate at the end of the reporting period.

15.6 Monetary item

A **monetary item** is defined as units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. Examples of monetary items will include:

- ☐ loans and receivables;
- ☐ pensions and other employee benefits to be paid in cash;
- ☐ provisions that are to be settled in cash; and
- ☐ cash dividends that are recognised as a liability.

The following are examples of non-monetary items:

- ☐ amounts prepaid for goods and services;
- ☐ goodwill;
- ☐ intangible assets;
- ☐ inventory;
- ☐ property, plant and equipment; and
- ☐ provisions that are to be settled by the delivery of a non-monetary asset.

15.7 Net investment in a foreign operation

An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the reporting entity's net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Translation from the functional currency to the presentation currency

IAS 21 requires the following approach in respect of the preparation of financial statements in another currency than the functional currency:

- ☐ Each entity (whether stand-alone, an entity with foreign operations or a foreign operation itself) determines its functional currency in terms of the principles discussed in paragraph 15.2 above.
- ☐ An entity translates foreign currency items (i.e. implying individual transactions that did not take place in the functional currency of the entity) into its functional currency and treats the translation in terms of IAS 21.20–.37 and .50.

- All entities forming part of the reporting entity should be included in the financial statements of the reporting entity. The financial results should be included in the financial statements of the reporting entity in the same presentation currency as that of the reporting entity, which could of course, be any currency/currencies.
- Should the entity to be included in the reporting entity have a different functional currency than the presentation currency of the reporting entity, the results of the entity will be translated in terms of the principles discussed in paragraph 15.8 below.
- Furthermore, any stand-alone entity that prepares financial statements (or an entity preparing separate financial statements in terms of **IAS 27 Separate Financial Statements**) may present its financial statements in any currency. If the presentation currency selected differs from the functional currency of that entity, the financial statements in the functional currency shall also be translated into the presentation currency selected using the principles discussed in paragraph 15.8.

15.8 Translation of financial statements to the presentation currency

The profit or loss, other comprehensive income and financial position of an entity shall be translated into a different presentation currency using the following procedures:

- assets and liabilities (including comparatives) shall be translated at the **closing rate** at the date of the statement of financial position;
- income and expenses (including comparatives) shall be translated at the exchange rate applicable **at the date of the transaction**. For practical reasons, an average exchange rate for the period is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period would be inappropriate; and
- all resulting exchange differences shall be recognised as a separate component of equity (commonly referred to as the foreign currency translation reserve (FCTR)) in **other comprehensive income**.

These exchange differences are not recognised in profit or loss, because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. The exchange differences simply resulted from translating income and expenses at the actual exchange rates and assets and liabilities at the closing rate, as well as the fact that the opening net assets are translated at the current closing rate that differs from the closing rate previously used to translate the balances in the previous period.

Equity is defined by the **Conceptual Framework** as the residual interest in the assets of an entity after deducting all its liabilities. However, the individual items of equity shall be translated at various different rates of exchange, depending on the category of equity. The following procedure in translating equity is typically used:

- Share capital is translated at the exchange rates that existed at the date of issue of the shares.
- Income and expense items are translated at the actual rate of exchange or the average rate that existed during the financial reporting period in which they arose. Therefore, the same principle will apply to retained earnings.
- Reserves that arose on specific dates (e.g., revaluation surpluses) are translated at the spot exchange rates that existed on the date the reserves arose.

When translating the financial statements of the reporting entity from its functional currency to the presentation currency, it is important to keep the accounting equation in mind.

The following example illustrates the above:

Example 15.1	Basic conversion of functional currency to presentation currency
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The financial results of X Ltd, a South African stand-alone entity with a functional currency of US Dollar (USD) and a chosen presentation currency of South African Rand (ZAR), are as follows at 31 December 20.28:

ASSETS	USD
Property, plant and equipment	\$100
EQUITY AND LIABILITIES	
Share capital	20
Retained earnings accumulated in 20.27	40
Profit for 20.28	30
Total equity	90
Long-term liability	10
	\$100

Applicable exchange rates	USD1,00 = ZAR
At inception (spot exchange rate)	3,00
Average rate for the 20.27 financial year	4,00
Average rate for the 20.28 financial year	5,00
31 December 20.28 (closing rate at reporting date)	6,50

Solution 15.1

The translated results of X Ltd on 31 December 20.28 are therefore as follows:

ASSETS	ZAR
Property, plant and equipment (USD100 × ZAR6,50)	650
EQUITY AND LIABILITIES	
Share capital (USD20 × ZAR3,00)	60
Retained earnings accumulated in 20.27 (USD40 × ZAR4,00)	160
Profit for 20.28 (USD30 × ZAR5,00)	150
Foreign currency translation reserve (FCTR) (balancing figure)	215
Total equity	585
Long-term liability (USD10 × ZAR6,50)	65
	R650

Proof of foreign currency translation reserve balance

As discussed above, equity is the **residual interest** in the assets of an entity after deducting all its liabilities. Therefore, total equity shall also be translated to the presentation currency **using the closing rate** as assets and liabilities are translated using the closing rate. As a result, the foreign currency translation reserve balance can also be calculated by analysing only the equity section of the statement of financial position:

	ZAR
Share capital (USD20 × ZAR3,00)	60
Retained earnings accumulated in 20.27 (USD40 × ZAR4,00)	160
Profit for 20.28 (USD30 × ZAR5,00)	150
	370
Total equity should be (USD90 × ZAR6,50)	585
	R215

Thus, the foreign currency translation reserve balance is



Comment

It is important to remember that all items in the financial statements should be translated at an exchange rate that best approximates the value of that item on the reporting date. Assets and liabilities should therefore be translated at the closing rate on the reporting date. Share capital is translated at the spot exchange rate at the share issue date. Retained earnings, income and expense items accrued over time and are therefore translated at the average exchange rates during the financial reporting period in which they arose.

15.9 Translation of a foreign operation

Many reporting entities comprise a number of individual entities (e.g., a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint arrangements. They may also have branches. It is necessary for the results and financial position of each entity included in the reporting entity to be translated from the functional currencies of the individual entities into the presentation currency of the reporting entity's financial statements.

When the results and financial position of a foreign operation are translated from the functional currencies of the individual entities into the presentation currency (so that the foreign operation can be included in the financial statements of the reporting entity by consolidation or the equity method) the applicable procedures discussed earlier in paragraph 15.8 should be applied in a similar way. In addition, the following principles should also be applied:

- ☐ Although total owners' interest (being all the assets and liabilities) is converted at the **closing rate**, certain components of owners' interest are translated at the historical exchange rate.
- ☐ Items of owners' interest at acquisition are translated at the **historical spot exchange rate** applicable when the equity interest was acquired. This conversion basis ensures that the goodwill or gain from a bargain purchase is determined once and for all and that it does not change in future, purely because exchange rates subsequently changed.

- Increases in components of owners' interest since acquisition to the beginning of the current period are converted at the **presentation currency equivalent at the time** at which these increases appeared in the previous period's conversion trial balance. This approach is essential to ensure that the consolidated balances at the beginning of the current period agree with the consolidated balances at the end of the previous period.
- Any goodwill arising on the acquisition of a foreign operation, and any IFRS 3 fair value remeasurements to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation, shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the **closing rate** annually. This principle is illustrated in example 15.3.
- Common items between the parent and the foreign operation (for example, dividends received/paid) are converted at the **actual exchange rate** applicable to these items on the respective dates that they arose.
- Transfers to reserves for the current period by the foreign operation are converted at the **closing rate**.

The cumulative amount of the exchange differences is presented in a separate component of equity (the **foreign currency translation reserve**) until disposal of the foreign operation.

When the exchange differences relate to a foreign operation that is consolidated but not wholly owned, accumulated exchange differences arising from translation and attributable to non-controlling interests are allocated to, and recognised as part of, non-controlling interests in the consolidated statement of financial position.

After the translation of the results and financial position of a foreign operation into the presentation currency in terms of paragraph 15.8, and taking into account the above, the incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, for example, the elimination of intragroup balances and intragroup transactions of a subsidiary.

Example 15.2	Basic conversion of the financial statements of a foreign subsidiary
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- 1 P Ltd is a South African company and has the South African Rand (ZAR) as its functional currency.
- 2 P Ltd acquired 80% of the issued shares of S Ltd, a foreign entity with FC as its functional currency, at the incorporation of the latter on 1 January 20.21. From this date P Ltd had control over S Ltd in accordance with IFRS 10. The reporting date of the group is 31 December.
- 3 P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.
- 4 The P Ltd group of companies elected to measure the non-controlling interest at its proportionate share of the acquiree's identifiable net assets at the acquisition date.
- 5 Assume a tax rate of 27% and a capital gains tax inclusion rate of 80%.

The following are the abbreviated trial balances of P Ltd and S Ltd for each of the financial periods 20.21, 20.22 and 20.23:

	20.21	20.22	20.23
P LTD	R	R	R
Assets			
Investment in S Ltd	80 000	80 000	80 000
Trade receivables	120 000	147 500	182 500
	200 000	227 500	262 500
Equity			
Share capital (100 000 shares)	100 000	100 000	100 000
Retained earnings: Beginning of the period	75 000	100 000	127 500
Profit for the current period	25 000	27 500	25 000
Dividends received from S Ltd	–	–	10 000
	200 000	227 500	262 500
S LTD	FC	FC	FC
Assets			
Trade receivables	120 000	145 000	165 000
Equity			
Share capital (100 000 shares)	100 000	100 000	100 000
Retained earnings: Beginning of the period	–	20 000	45 000
Profit for the current period	20 000	25 000	30 000
Dividend paid	–	–	(10 000)
	120 000	145 000	165 000

**Comment**

FC represents the foreign currency unit concerned.

Applicable exchange rates	FC1,00 = ZAR
1/1/20.21	1,00
Average for period 20.21	1,05
31/12/20.21	1,11
Average for period 20.22	1,18
31/12/20.22	1,25
Average for period 20.23	1,28
31/12/20.23	1,33

Solution 15.2

The consolidated financial statements of P Ltd and its foreign subsidiary will be drafted in **Rand** as follows for each of the periods concerned:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER			
	20.21	20.22	20.23
ASSETS			
Current assets			
Trade receivables			
(R120 000(P) + (FC120 000 × R1,11)(S))	253 200		
(R147 500(P) + (FC145 000 × R1,25)(S))		328 750	
(R182 500(P) + (FC165 000 × R1,33)(S))			401 950
Total assets	R253 200	R328 750	R401 950
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital (P)	100 000	100 000	100 000
Retained earnings	116 800	167 900	223 620
Other components of equity (C2); (C5); (C8)	9 760	24 600	34 440
	226 560	292 250	358 060
Non-controlling interests (C2); (C5); (C8)	26 640	36 250	43 890
Total equity	253 200	328 750	401 950
Total equity and liabilities	R253 200	R328 750	R401 950

P LTD GROUP EXTRACT FROM CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER			
	20.21	20.22	20.23
PROFIT FOR THE YEAR (R25 000(P) + (FC20 000 × R1,05)(S)) (R27 500(P) + (FC25 000 × R1,18)(S)) (R25 000(P) + (FC30 000 × R1,28)(S))	46 000	57 000	63 400
Other comprehensive income: Items that may be reclassified subsequently to profit or loss: Exchange differences arising on translating foreign operations ^a (C1)/(C2); (C4)/(C5); (C7)/(C8)	12 200	18 550	12 300
Other comprehensive income for the year, net of tax	12 200	18 550	12 300
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R58 200	R75 550	R75 700
Profit attributable to: Owners of the parent (balancing) Non-controlling interests (FC20 000 × R1,05 × 20%) (FC25 000 × R1,18 × 20%) (FC30 000 × R1,28 × 20%)	41 800 4 200	51 100 5 900	55 720 7 680
	R46 000	R57 000	R63 400
Total comprehensive income attributable to: Owners of the parent (balancing) Non-controlling interests ^b (R4 200 + (R12 200 × 20%)) (R5 900 + (R18 550 × 20%)) (R7 680 + (R12 300 × 20%))	51 560 6 640	65 940 9 610	65 560 10 140
	R58 200	R75 550	R75 700

**Comments**

- a Exchange differences arising on translating foreign operations are presented at 100% (i.e. not net of non-controlling interest) in the statement of profit or loss and other comprehensive income.
- b The non-controlling interests in total comprehensive income can also be reconciled as follows:

	20.21	20.22	20.23
Profit for the year (analysis)	4 200	5 900	7 680
Other comprehensive income for the year (analysis)	2 440	3 710	2 460
	R6 640	R9 610	R10 140

P LTD GROUP
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER

	Share capital	FCTR	Retained earnings	Total	NCI	Total equity
Balance at 1 January 20.21	100 000	—	75 000	175 000	—	175 000
Acquisition of subsidiary	—	—	—	—	20 000	20 000
Total comprehensive income for the year:						
Profit for the year	—	—	41 800	41 800	4 200	46 000
Other comprehensive income	—	9 760	—	9 760	2 440	12 200
Balance at 31 December 20.21	100 000	9 760	¹ 116 800	226 560	26 640	253 200
Total comprehensive income for the year:						
Profit for the year	—	—	51 100	51 100	5 900	57 000
Other comprehensive income	—	14 840	—	14 840	3 710	18 550
Balance at 31 December 20.22	100 000	24 600	² 167 900	292 500	36 250 (2 500)	328 750 (2 500)
Dividends	—	—	—	—	—	—
Total comprehensive income for the year:						
Profit for the year	—	—	55 720	55 720	7 680	63 400
Other comprehensive income	—	9 840	—	9 840	2 460	12 300
Balance at 31 December 20.23	R100 000	R34 440	³ R223 620	R358 060	R43 890	R401 950

FCTR = Foreign currency translation reserve

NCI = Non-controlling interests

(1) Test: 100 000 + 16 800 = 116 800

(2) Test: 127 500 + 40 400 = 167 900

(3) Test: 162 500 + 61 120 = 223 620

Calculations

C1 Conversion trial balance of S Ltd at 31 December 20.21

	FC	Rate	R
Trade receivables	120 000	R1,11	133 200
Share capital	(100 000)	R1,00	(100 000)
Profit for 20.21	(20 000)	R1,05	(21 000)
Exchange differences on translation: 31/12/20.21 (balancing) (OCI)	—		(12 200)
	—		—



Comments

- a All the assets and liabilities, as well as the total ownership interest of S Ltd, are converted at the **closing rate** (i.e. R1,11 = F1,00) on 31 December 20.21. Always keep in mind the accounting equation, i.e.:
- $$\text{Equity} = \text{Assets} - \text{Liabilities}$$
- b The exchange rate conversion difference, which is known as the foreign currency translation reserve (FCTR), is brought about by the fact that components of equity are not all converted at the closing rate, as assets and liabilities.
- ☐ The acquisition date equity is converted at the historical exchange rate applicable when the equity investment was made (e.g. R1,00 = F1,00). The use of the historical exchange rate ensures that the goodwill or gain from a bargain purchase on consolidation is determined once and for all, so that it will not change in the future merely because the exchange rate has changed.
 - ☐ Items of profit or loss for the current period are generally converted at the average exchange rate for the period (e.g. R1,05 = F1,00).
- c The net assets of the subsidiary increased during 20.21 by R33 200 (being R133 200 less R100 000). R21 000 is attributable to the net profit for 20.21. The balance of the increase, namely R12 200, arose because the Rand weakened against the foreign monetary unit. The exchange differences on translation are recognised in other comprehensive income. These movements in other comprehensive income are then accumulated in equity under the heading of foreign currency translation reserve. The foreign currency translation reserve, in essence, represents a remeasurement reserve originating from the restatement of P Ltd's net investment in S Ltd to the current exchange rate.
- d In this example, deferred tax has not been recognised on the exchange differences accumulated in the foreign currency translation reserve. Valid arguments also exist for the provision of deferred tax on the translation gain or loss. Refer **IAS 12 Income Taxes** in this regard.

C2 Analysis of owners' equity of S Ltd at 31 December 20.21

	Total R	P Ltd 80%		NCI
		At	Since	
i At acquisition date				
Share capital	100 000	80 000		20 000
	100 000	80 000		20 000
Equity represented by goodwill – Parent	–	–		–
Consideration and NCI	100 000	80 000		20 000
ii Since acquisition				
• Current year:				
Profit for the year	21 000		16 800	4 200
Exchange differences on translation (OCI)	12 200		9 760	2 440
	R133 200		R16 800 RE	R26 640
			R9 760 FCTR	

RE = Retained earnings

FCTR = Foreign currency translation reserve

C3 Pro forma consolidation journal entries at 31 December 20.21

		Dr R	Cr R
J1	Share capital (SCE) (FC100 000 × R1,00) Investment in S Ltd (SFP) Non-controlling interests (SCE) (R100 000 × 20%) Elimination of equity at acquisition date	100 000	80 000 20 000
J2	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in current year's profit (FC20 000 × R1,05 × 20%)	4 200	4 200
J3	Non-controlling interests (OCI) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in the exchange differences on translation for current year (R12 200 × × 20%)	2 440	2 440

**Comment**

Note that the total exchange differences on translation of R12 200 do not get journalised into the consolidated financial statements. It is included in the converted Rand trial balance which is combined with the parent's trial balance on a line-by-line basis. The only journal required in respect of the exchange differences on translation is the allocation of the non-controlling interests' portion (refer journal 3).

C4 Conversion trial balance of S Ltd at 31 December 20.22

	FC	Rate	R
Trade receivables	145 000	R1,25	181 250
Share capital	(100 000)	R1,00	(100 000)
Retained earnings 1/1/20.21 to 31/12/20.21	(20 000)	A	(21 000)
FCTR balance 31/12/20.21 (SCE)	—		(12 200)
Profit for 20.22	(25 000)	R1,18	(29 500)
Exchange differences on translation:			
Movement for 20.22 (balancing) (OCI)	—		(18 550)
	—		—

A = Actual amount as per previous period's consolidated statement of financial position

	Comments
	a All assets and liabilities (i.e. total ownership interest) are converted at the closing rate (i.e. R1,25 = FC1,00) on 31 December 20.22. b The exchange differences on translation for 20.22 occur because: ☐ The profit for 20.22 is translated at the average rate of exchange, while the corresponding assets and liabilities are translated at the closing rate of exchange on 31 December 20.22. ☐ The opening net assets for 20.22 are translated at the closing rate of exchange on 31 December 20.22, which differs from the previous 20.21 closing rate of exchange. c Note that the balance of the foreign currency translation reserve as at the end of 20.21 (i.e. R12 200) is taken up in the conversion trial balance at 31 December 20.22.

C5 Analysis of owners' equity of S Ltd at 31 December 20.22

	Total R	P Ltd 80%		NCI
		At	Since	
i At acquisition date				
Share capital	100 000	80 000		20 000
	100 000	80 000		20 000
Equity represented by goodwill – Parent	—	—		—
Consideration and NCI	100 000	80 000		20 000
ii Since acquisition				
• To beginning of current year:				
Retained earnings	21 000		16 800	4 200
Foreign currency translation reserve	12 200		9 760	2 440
• Current year:				
Profit for the year	29 500		23 600	5 900
Exchange differences on translation (OCI)	18 550		14 840	3 710
	R181 250		R40 400 RE	R36 250
			R24 600 FCTR	

C6 Pro forma consolidation journal entries at 31 December 20.22

		Dr R	Cr R
J1	Share capital (SCE) (FC100 000 × R1,00) Investment in S Ltd (SFP) Non-controlling interests (SCE) (R100 000 × 20%) Elimination of equity at acquisition date	100 000	80 000 20 000
J2	Retained earnings – Beginning of year (SCE) (FC20 000 × R1,05 × 20%) FCTR – Beginning of year (SCE) (R12 200 × 20%) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in retained earnings and FCTR to beginning of current year	4 200 2 440	6 640
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in current year's profit (FC25 000 × R1,18 × 20%)	5 900	5 900
J4	Non-controlling interests (OCI) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in current year's FCTR movement (R18 550 × 20%)	3 710	3 710

C7 Conversion trial balance of S Ltd at 31 December 20.23

	FC	Rate	R
Trade receivables	165 000	R1,33	219 450
Share capital	(100 000)	R1,00	(100 000)
Retained earnings: 1/1/20.21 to 31/12/20.22	(45 000)	A	(50 500)
Foreign currency translation reserve (SCE) (12 200 + 18 550)	–		(30 750)
Profit for 20.23	(30 000)	R1,28	(38 400)
Dividend paid	10 000	A	12 500
Exchange differences on translation: Movement for 20.23 (Balancing) (OCI)	–		(12 300)
	–		–

A = Actual amount as per previous period's consolidated statement of financial position, or when the dividend was paid

	Comments a All assets and liabilities (i.e. total ownership interest) are converted at the closing rate (i.e. R1,33 = FC1,00) on 31 December 20.23. b The exchange differences on translation for 20.23 occur because: □ the profit for 20.23 is translated at the average rate of exchange, while the corresponding assets and liabilities are translated at the closing rate of exchange on 31 December 20.23; and □ the opening net assets for 20.23 are translated at the closing rate of exchange on 31 December 20.23, which differs from the previous 20.22 closing rate of exchange. c Note that the balance of the foreign currency translation reserve at the end of 20.22 (i.e. R30 750) has been directly taken up in the conversion trial balance at 31 December 20.23. d The dividends paid by the subsidiary are converted to an appropriate equivalent by scaling up the actual amount received by P Ltd to 100% (R10 000/0,8). e The net assets of the subsidiary increased during 20.23 by R38 200 (R219 450 – R181 250); R25 900 (R38 400 – R12 500) of which is attributable to retained earnings for 20.23. The balance of the increase, namely R12 300, occurred as a result of the weakening of the Rand against the foreign currency unit.
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C8 Analysis of owners' equity of S Ltd at 31 December 20.23

	Total R	P Ltd 80%		NCI
		At	Since	
i At acquisition date				
Share capital	100 000	80 000		20 000
	100 000	80 000		20 000
Equity represented by goodwill – Parent	–	–		–
Consideration and NCI	100 000	80 000		20 000
ii Since acquisition				
• To beginning of current year:				
Retained earnings	50 500		40 400	10 100
Foreign currency translation reserve (12 200 + 18 550)	30 750		24 600	6 150
• Current year:				
Profit for the year	38 400		30 720	7 680
Dividend	(12 500)		(10 000)	(2 500)
Exchange differences on translation (OCI)	12 300		9 840	2 460
	R219 450		R61 120 RE	R43 890
			R34 440 FCTR	

C9 Pro forma consolidation journal entries at 31 December 20.23

		Dr R	Cr R
J1	Share capital (SCE) ($FC100\,000 \times R1,00$) Investment in S Ltd (SFP) Non-controlling interests (SCE) ($R100\,000 \times 20\%$) Elimination of equity at acquisition date	100 000	80 000 20 000
J2	Retained earnings – Beginning of year (SCE) ($R4\,200(20.21) + R5\,900(20.22)$) FCTR – Beginning of year (SCE) ($R2\,440(20.21) + R3\,710(20.22)$) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in retained earnings and FCTR to beginning of current year	10 100 6 150	16 250
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in current year's profit ($FC30\,000 \times R1,28 \times 20\%$)	7 680	7 680
J4	Non-controlling interests (OCI) Non-controlling interests (SCE) Recognition of non-controlling interests' portion in current year's FCTR movement ($R12\,300 \times 20\%$)	2 460	2 460
J5	Dividend received (P/L) ($R12\,500 \times 80\%$) Non-controlling interests (SCE) ($R12\,500 \times 20\%$) Dividend paid (SCE) ($FC10\,000 \times R1,25$) Elimination of intragroup dividend in consolidated financial statements	10 000 2 500	12 500

Example 15.3a

The impact of goodwill and IFRS 3 fair value remeasurements on foreign operations (NCI is measured at its proportionate share of the acquiree's identifiable net assets at the acquisition date)

- 1 P Ltd is a South African company and has the South African Rand (ZAR) as its functional currency.
- 2 P Ltd acquired 75% of S Ltd, a foreign entity with FC as its functional currency, on 1 January 20.21 for FC3 000. At that date, S Ltd had share capital of FC1 000 and retained earnings of FC2 000. From 1 January 20.21, P Ltd had control over S Ltd as per the definition of control in accordance with **IFRS 10 Consolidated Financial Statements**. All of S Ltd's assets and liabilities were considered to be fairly valued on acquisition date, except for land which was undervalued by FC500.
- 3 S Ltd's retained earnings increased by FC300 in 20.21 and FC400 in 20.22.
- 4 During the 20.22 financial year, P Ltd sold inventory to S Ltd. On 31 December 20.22, inventory purchased from P Ltd amounting to FC20 was still on hand. Total sales from P Ltd to S Ltd for the 20.22 financial year amounted to FC30. P Ltd sells inventory at a mark-up of 20% on cost.
- 5 P Ltd recognised the equity investment in S Ltd in its separate records using the cost price method.
- 6 The P Ltd group elected to measure the non-controlling interest at its proportionate share of the acquiree's identifiable net assets at the acquisition date.
- 7 It is the accounting policy of S Ltd to measure all items of property, plant and equipment according to the cost model in terms of **IAS 16 Property, Plant and Equipment**.
- 8 Ignore any effects of taxation.
- 9 The following exchange rates are applicable:

	FC1,00 = ZAR
1/1/20.21	2,00
Average 20.21	2,10
31/12/20.21	2,20
Average 20.22	2,40
31/12/20.22	2,50

**Comments**

Remember goodwill and the fair value remeasurements are deemed to be part of the **foreign entity** (IAS 21.47). However, these items are not recorded in S Ltd's individual records. These items are recognised through pro forma consolidation journals, and additional pro forma consolidation journals are needed to account for the translation thereof.

Solution 15.3a

The analysis of owners' equity of S Ltd and pro forma consolidation journal entries would be as follows:

C1 Analysis of owners' equity of S Ltd

	100% FC	Rate	100% R	At 75% R	Since 75% R	NCI 25% R
i At acquisition						
Share capital	1 000	R2,00	2 000	1 500		500
Retained earnings	2 000	R2,00	4 000	3 000		1 000
Fair value remeasurement (land)	500	R2,00	1 000	750		250
	3 500	R2,00	7 000	5 250		1 750
Equity represented by goodwill – Parent	375	R2,00	750	750		–
Consideration and NCI	3 875		7 750	6 000		1 750
ii Since acquisition						
• To beginning of current year:						
Retained earnings increase 20.21	300	R2,10 (average)	630		472 RE	158
FCTR (excluding goodwill)			730		548FCTR	182
FCTR (goodwill only)			¹ 75		75FCTR	–
	4 175	R2,20	9 185		1 095	2 090
• Current year:						
Retained earnings increase 20.22	400	R2,40 (average)	960		720 RE	240
Exchange differences on translation (OCI) (excluding goodwill)			1 180		885FCTR	295
Exchange differences on translation (OCI) (goodwill only)			² 113		113FCTR	–
	FC4 575	R2,50	R11 438		R2 813 R1 621FCTR R1 192 RE	R2 625



Comments

The following steps are followed in calculating the exchange differences on translation of R730 for the 20.21 financial year:

Step 1: Translate the foreign currency at acquisition owners' equity of FC3 500 to the presentation currency using the rate applicable at acquisition.

Step 2: Calculate the goodwill in the presentation currency (R750) and convert it back to the foreign currency (FC375) as IAS 21 states that goodwill is treated as an asset of the foreign operation.

Step 3: Translate the profit for the 20.21 financial year to the presentation currency.

Step 4: Remeasure goodwill to the closing rate at the end of the 20.21 financial year (see below).

Step 5: Translate the year-end total foreign currency owners' equity of FC4 175 to the presentation currency using the closing rate ($FC4\ 175 \times R2,20 = R9\ 185$).

Step 6: The exchange differences on translation for the 20.21 financial year will be the **balancing amount** in the presentation currency column ($R9\ 185 - R75 - R630 - R7\ 750$).

The same principle will apply when calculating the exchange differences on translation of R1 180 for the 20.22 financial year.

Goodwill remeasurement calculation (method only used in respect of foreign entities)

	FC	Rate	R
At acquisition date	FC375	R2,00	750
FCTR 20.21			¹ 75
31/12/20.21	FC375	R2,20	825
Exchange differences on translation: 20.22			² 113
31/12/20.22	FC375	R2,50	R938

Note the FC375 amounts remains constant (as was determined at the acquisition date). This amount is translated every reporting to Rand using the **spot rate**.

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	6 000
Amount of non-controlling interest: IFRS 3.32(a)(ii)	1 750
	7 750
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(7 000)
Goodwill (parent only)	R750

C3 Proof of foreign currency translation reserve balance at 31 December 20.22

	FC	Rate	R
Share capital	(1 000)	R2,00	(2 000)
Land remeasurement	(500)	R2,00	(1 000)
Retained earnings:			
At acquisition	(2 000)	R2,00	(4 000)
Profit for 20.21	(300)	R2,10	(630)
Profit for 20.22	(400)	R2,40	(960)
Net assets	¹ 4 200	R2,50	10 500
Foreign currency translation reserve	–		¹ (1 910)
	<u>–</u>		<u>–</u>

(1) Balancing

**Comments**

The foreign currency translation reserve of R1 910 agrees to the year-end balance of the reserve and includes the opening balance of R730 as well as the current year movement of R1 180.

C4 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Land (SFP) Equity at acquisition (SCE) Fair value remeasurement on land	1 000	1 000
J2	Share capital (SCE) Retained earnings (SCE) Equity at acquisition (SCE) Goodwill (SFP) Non-controlling interests (SCE) Investment in S Ltd (SFP) (at cost price) Elimination of acquisition date equity	2 000 4 000 1 000 750	1 750 6 000
J3	Retained earnings – Beginning of year (SCE) Non-controlling interests (SCE) Recognition of non-controlling interests' portion of retained earnings since acquisition to beginning of current year	158	158
J4	FCTR – Beginning of year (SCE) Non-controlling interests (SCE) Recognition of non-controlling interests' portion of FCTR since acquisition to beginning of current year	182	182

continued

		Dr R	Cr R
J5	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of non-controlling interests' portion of current year's profit	240	240
J6	Non-controlling interests (OCI) Non-controlling interests (SCE) Allocate non-controlling interests' portion of current year's FCTR	295	295
J7	Goodwill (SFP) (R938 – R750) FCTR – Beginning of year (SCE) Exchange differences on translation (OCI) Remeasure goodwill to closing rate at reporting date – the non-controlling interest does NOT share in this portion of the FCTR (comment (b))	188	75 113
J8	Land (SFP) FCTR – Beginning of year (SCE) ($FC500 \times (R2,20 - R2,00)$) Exchange differences on translation (OCI) ($FC500 \times (R2,50 - R2,20)$) Recording effect of movement in exchange rate i.r.o. fair value remeasurement on land (comment (a))	250	100 150
J9	Revenue (P/L) Cost of sales (P/L) Elimination of intragroup sales ($FC30 \times R2,40$)	72	72
J10	Cost of sales (P/L) Inventory (SFP) Elimination of unrealised profit on inventory (comment (c)) ($FC20 \times R2,50 \times 20/120$)	8	8



Comments

- a Land is not presented on the subsidiary's FC-denominated trial balance (i.e. before conversion) at the remeasured amount. Therefore, the FCTR that arose on the subsidiary's Rand-denominated trial balance (i.e. after conversion and before consolidation) was not completely correct from a group perspective, because the pre-conversion trial balance does not take into account any pro forma adjustments that are required at group level (e.g. fair value remeasurement on land i.t.o. IFRS 3). This principle is very similar to an asset that is remeasured on a pro forma basis at group level, where the subsequent depreciation is then also corrected at group level on a pro forma basis. As such, additional **pro forma journals** are needed to account for the translation of the **remeasurements** of items as at the acquisition date.
- The non-controlling interest does share in this FCTR movement of R250, and this is already taken into account in the non-controlling interest amounts of R182 (prior-period FCTR) and R295 (current-period exchange difference). This is so because the FCTR movements in the analysis above are calculated on a net equity value **inclusive** of the effect of the remeasurement on land (note that the remeasurement of the land of FC500 is included in the total column of the analysis and is included in the amount of FC4 175, which is used to calculate the FCTR movement as was explained through the various steps in the comments to the analysis above).
- b In this example, the non-controlling interest is measured at the proportionate share of the acquiree's identifiable net assets at acquisition. When this method is followed, the **non-controlling interest does NOT share in the FCTR on goodwill**. However, where the non-controlling interest is measured at fair value at acquisition, the non-controlling interest will have a share in the FCTR on goodwill, as is illustrated below. This share is based on the profit-sharing (ownership interest) ratio (see IFRS 10.B94, IAS 36, Illustrative Example 7B, IE68E).
- c Journal 10 is eliminating the unrealised profit included in the **inventory balance at year-end**. As the unrealised profit is only eliminated at reporting date and not throughout the year, the closing rate (R2,50) will be used to translate the journal to the functional currency. There are, however, different schools of thought on this principle. It can also be argued that the elimination of any intragroup transactions will follow the same translation principle, as discussed in 15.8 above:
- ☐ assets and liabilities shall be translated at the closing rate at the date of the statement of financial position;
 - ☐ income and expenses shall be translated at the exchange rate applicable at the date of the transaction or an average exchange rate for the period; and
 - ☐ all resulting exchange differences shall be recognised in the foreign currency translation reserve (FCTR)) in other comprehensive income.

Example 15.3b	The impact of goodwill and IFRS 3 fair value remeasurements on foreign operations (NCI is measured at fair value at the acquisition date)
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Assume the same information as in example 15.3a, except that P Ltd elected to measure non-controlling interests at fair value at the acquisition date. The fair value of the non-controlling interests was R1 800 at the acquisition date.

Solution 15.3b

The analysis of owners' equity of S Ltd and pro forma consolidation journal entries would be as follows:

C1 Analysis of owners' equity of S Ltd

	100% FC	Rate	100% R	At 75% R	Since 75% R	NCI 25% R
i At acquisition						
Share capital	1 000	R2,00	2 000	1 500		500
Retained earnings	2 000	R2,00	4 000	3 000		1 000
Fair value remeasurement (land)	500	R2,00	1 000	750		250
	3 500	R2,00	7 000	5 250		1 750
Equity represented by goodwill – Parent and NCI	400	R2,00	800	750		50
Consideration and NCI	3 900		7 800	6 000		1 800
ii Since acquisition						
• To beginning of current year:						
Retained earnings movement 20.21	300	R2,10 (average)	630		472 RE	158
FCTR (excluding goodwill)			730		548FCTR	182
FCTR (goodwill only)			80		60FCTR	20
	4 200	R2,20	9 240		1 080	2 160
• Current year:						
Retained earnings movement 20.22	400	R2,40 (average)	960		720 RE	240
Exchange differences on translation (excluding goodwill)			1 180		885FCTR	295
Exchange differences on translation (goodwill only)			120		90FCTR	30
	FC4 600	R2,50	R11 500		R2 775 R1 192 RE R1 583FCTR	R2 725

	Comment		
	Goodwill remeasurement calculation (method only used in respect of foreign entities)		
		FC	Rate
	At acquisition date	FC400	R2,00
	FCTR 20.21		800
	31/12/20.21	FC400	R2,20
	Exchange differences on translation: 20.22		880
	31/12/20.22	FC400	R2,50
			R1 000

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	6 000
Amount of non-controlling interests: IFRS 3.32(a)(ii)	1 800
	7 800
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(7 000)
Goodwill (parent and NCI)	R800

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Land (SFP) Equity at acquisition (SCE) Fair value remeasurement on land	1 000	1 000
J2	Share capital (SCE) Retained earnings (SCE) Equity at acquisition (SCE) Goodwill (SFP) Non-controlling interests (SCE) Investment in S Ltd (SFP) (at cost price) Elimination of acquisition date equity	2 000 4 000 1 000 800	1 800 6 000
J3	Retained earnings – Beginning of year (SCE) Non-controlling interests (SCE) Recognition of non-controlling interests’ portion of retained earnings since acquisition to beginning of current year	158	158
J4	FCTR – Beginning of year (SCE) Non-controlling interests (SCE) (R182 + R20) Recognition of non-controlling interests’ portion of FCTR since acquisition to beginning of current year	202	202

continued

		Dr R	Cr R
J5	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of non-controlling interests' portion of current year's profit	240	240
J6	Non-controlling interests (OCI) Non-controlling interests (SCE) (R295 + R30) Recognition of non-controlling interests' portion of current year's FCTR	325	325
J7	Goodwill (SFP) (R1 000 – R800) FCTR – Beginning of year (SCE) Exchange differences on translation (OCI) Remeasure goodwill to closing rate at reporting date – the non-controlling interests does share in this portion of the FCTR (comment (a))	200	80 120
J8	Land (SFP) FCTR – Beginning of year (SCE) (FC500 × (R2,20 – R2,00)) Exchange differences on translation (OCI) (FC500 × (R2,50 – R2,20)) Recording effect of movement in exchange rate i.r.o. fair value remeasurement on land	250	100 150
J9	Revenue (P/L) Cost of sales (P/L) Elimination of intragroup sales (FC30 × R2,40)	72	72
J10	Cost of sales (P/L) Inventory (SFP) Elimination of unrealised profit on inventory (FC20 × R2,50 × 20/120)	8	8

**Comment**

The non-controlling interest does share in the FCTR on goodwill, and this is already taken into account in the non-controlling interest amounts of R202 (R182 + **R20**) and R325 (R295 + **R30**).

15.10 Foreign operation and reporting entity have different reporting dates

When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done, **IFRS 10 Consolidated Financial Statements** allows the use of a different reporting date, provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate on the statement of financial position date of the foreign

operation. Adjustments are made for significant changes in exchange rates up to the statement of financial position date of the reporting entity in accordance with IFRS 10.

The same approach is used in applying the equity method to associates and joint ventures in accordance with **IAS 28 Investments in Associates and Joint Ventures**.

15.11 Net investment in a foreign operation

A net investment in a foreign operation is the amount of the reporting entity’s interest in the **net assets of that operation**. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity’s **net investment in that foreign operation**. For example, the reporting entity may have granted a loan to the foreign operation, which may or may not bear interest and for which settlement is not planned. This loan will be, in substance, part of the reporting entity’s net investment in that foreign operation.

Exchange differences arising on a monetary item that forms part of a reporting entity’s net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. However, in the consolidated financial statements of the reporting entity that include the foreign operation, such an **exchange difference shall be recognised in other comprehensive income** (foreign currency translation reserve). Thus, the pro forma consolidation journals would normally include a reclassification journal that reclassifies the exchange differences from profit or loss to other comprehensive income.

Example 15.4a	Loan to subsidiary as part of the net investment in a foreign operation (Loan denominated in foreign currency)
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- 1 P Ltd is a South African company and has the South African Rand (ZAR) as its functional currency.
- 2 P Ltd obtained a controlling interest in S Ltd, a foreign subsidiary, with FC as its functional currency, at the beginning of the financial year.
- 3 As part of the purchase agreement P Ltd granted a loan to S Ltd to the value of FC1 000. The loan bears interest at a market-related interest rate of 10% per annum, payable annually. The repayment of the loan is, however, not expected in the foreseeable future. P Ltd regarded the loan as part of its net investment in S Ltd.
- 4 According to P Ltd’s accounting policy, only the capital amount of the loan amount is included as part of the net investment in a foreign operation.
- 5 Ignore any effects of taxation.
- 6 The following exchange rates are applicable:

	FC1,00 = ZAR
At acquisition	2,00
Average for period	2,50
Year-end	3,00

Solution 15.4a

The journal entries in the **separate** accounting records of **P Ltd** would be as follows:

		Dr R	Cr R
J1	Initial recognition Loan to subsidiary (SFP) (FC1 000 × R2,00) Bank (SFP) Initial recognition of the loan at the spot exchange rate	2 000	2 000
J2	Reporting date Bank (SFP) (FC1 000 × 10% × R3,00) Interest received (P/L) (FC100 × R2,50) Foreign exchange differences (P/L) Recognition of interest received on foreign loan	300	250 50
J3	Loan to subsidiary (SFP) ((FC1 000 × R3,00) – R2 000) Foreign exchange differences (P/L) Restatement of foreign loan to the spot exchange rate	1 000	1 000



Comment

The loan is stated (**denominated**) in **FC**, which implies that P Ltd will consistently translate the loan amount to Rand. P Ltd will recognise the foreign exchange differences in its profit or loss (J2) (IAS 21.28). However, in the group's consolidated financial statements, such exchange differences should be recognised in other comprehensive income (IAS 21.32), as the loan forms part of P Ltd's net investment in S Ltd. This consolidation adjustment is illustrated in the pro forma consolidation journal entries below (J1).

The journal entries in the **individual** accounting records of **S Ltd** would be as follows:

		Dr FC	Cr FC
J1	Initial recognition Bank (SFP) Loan from parent (SFP) Initial recognition of the loan	1 000	1 000
J2	Reporting date Interest paid (P/L) (FC1 000 × 10%) Bank (SFP) Recognition of interest paid on loan from parent	100	100

The conversion trial balance of S Ltd at year-end

	FC	Rate	R
Interest paid	100	R2,50	250
Loan from parent	(1 000)	R3,00	(3 000)
Equity (Balancing)	900	R3,00	2 700
Exchange differences on translation:			
Year-end (Balancing)	—		50
	—		—

The following **pro forma consolidation** journal entries should be processed at year-end:

		Dr R	Cr R
J1	Foreign exchange differences (P/L) Exchange differences on translation (OCI) Reclassification of the exchange differences that relate the net investment in the foreign operation	1 000	1 000
J2	Interest received (P/L) Interest paid (P/L) Elimination of intragroup interest received and paid	250	250
J3	Loan from parent (SFP) Loan to subsidiary (SFP) Elimination of intragroup loan	3 000	3 000

Example 15.4b

Loan to subsidiary as part of the net investment in a foreign operation (Loan denominated in reporting currency)

Assume the same information as stated above, except that the loan granted was denominated in the **functional currency** of the **parent**. The loan to S Ltd amounted to R2 000.

Solution 15.4b

The journal entries in the **separate** accounting records of **P Ltd** would be as follows:

		Dr R	Cr R
J1	Initial recognition Loan to subsidiary (SFP) Bank (SFP) Initial recognition of the loan	2 000	2 000
J2	Reporting date Bank (SFP) (R2 000 × 10%) Interest received (P/L) Recognition of interest received on foreign loan	200	200

	Comment The loan is stated (denominated) in Rand, which implies that S Ltd will consistently translate the loan amount to FC. S Ltd will recognise the foreign exchange differences in its profit or loss. The amounts for the loan, interest and foreign exchange differences will form part of S Ltd trial balance that is translated to Rand, as illustrated below.
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The journal entries in the **individual** accounting records of **S Ltd** would be as follows:

		Dr FC	Cr FC
J1	Initial recognition Bank (SFP) (R2 000/FC2,00) Loan from parent (SFP) Initial recognition of the loan at the spot exchange rate	1 000	1 000
J2	Reporting date Interest paid (P/L) ((R2 000 × 10%)/FC2,50) Bank (SFP) ((R2 000 × 10%)/FC3,00) Foreign exchange differences (P/L) Recognition of interest paid on loan from parent	80	67 13
J3	Loan from parent (SFP) ((R2 000/FC3,00) – FC1 000) Foreign exchange differences (P/L) Restatement of foreign loan to the spot exchange rate	333	333

The conversion trial balance of S Ltd at year-end:

	FC	Rate	R
Interest expense	80	R2,50	200
Foreign exchange differences on interest	(13)	R2,50	(33)
Foreign exchange differences on loan	(333)	R2,50	(832)
Loan from parent (1 000 – 333)	(667)	R3,00	(2 000)
Equity (Balancing)	933	R3,00	2 799
Exchange differences on translation:			
Year-end (Balancing)	—		(134)
	—		—

The following **pro forma consolidation** journal entries should be processed at year-end:

		Dr R	Cr R
J1	Foreign exchange differences (P/L) Exchange differences on translation (OCI) Reclassification of the exchange differences that relate the net investment in the foreign operation	832	832
J2	Interest received (P/L) Interest paid (P/L) Elimination of intragroup interest received and paid	200	200
J3	Loan from parent (SFP) Loan to subsidiary (SFP) Elimination of intragroup loan	2 000	2 000



Comments

In the example above, P Ltd's **accounting policy** is to include only the capital amount of the loan (not the interest component) amount as part of the net investment in a foreign operation. There are, however, different schools of thought on this principle. It can also be argued that the interest is considered part of the net investment in a foreign operation. If this is the case, the exchange differences on translation of the interest to the presentation currency will also be reclassified to other comprehensive income in accordance with IAS 21.32 upon consolidation. It would be sensible to disclose what is included (capital and/or interest) in the net investment in a foreign operation in the accounting policy of the group.

15.12 Foreign operations – Associates and joint ventures

When a parent has an investment in a foreign operation in the form of an associate or joint venture, the translation of the foreign operation follows the same guidelines as discussed in paragraph 15.8. Assets and liabilities shall be translated at the closing rate, and income and expenses shall be translated at the exchange rate applicable at the date of the transaction or an average rate. The resulting exchange differences shall be recognised as a separate component of equity (commonly referred to as the foreign currency translation reserve (FCTR)) in **other comprehensive income** until such time as the associates or joint ventures are disposed of.

Example 15.5	Foreign operation – Associate
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.25		
	P Ltd Group R	A Ltd FC
ASSETS		
Property, plant and equipment	139 000	18 000
Investment in A Ltd (300 shares at cost)	6 000	–
Inventories	50 000	10 000
Total assets	R195 000	FC28 000
EQUITY AND LIABILITIES		
Share capital (10 000/1 000 shares)	10 000	1 000
Retained earnings	120 000	7 700
Non-controlling interests	25 000	–
Trade and other payables	40 000	19 300
Total equity and liabilities	R195 000	FC28 000

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.25		
	P Ltd Group R	A Ltd FC
Profit		
Dividends received from A Ltd	199 328	3 000
	672	–
Profit before tax	200 000	3 000
Income tax expense	(94 000)	(1 500)
PROFIT FOR THE YEAR	106 000	1 500
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R106 000	FC1 500
Total comprehensive income attributable to:		
Owners of the parent	91 000	1 500
Non-controlling interests	15 000	–
	R106 000	FC1 500

**EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20.25**

	Retained earnings	
	P Ltd Group R	A Ltd FC
Balance at 1 January 20.25	79 000	7 000
Changes in equity for 20.25		
Dividends paid	(50 000)	(800)
Total comprehensive income for the year:		
Profit for the year	91 000	1 500
Balance at 31 December 20.25	R120 000	FC7 700

- 1 P Ltd is a South African company and has the South African Rand (ZAR) as its functional currency.
- 2 P Ltd obtained a 30% interest in A Ltd, a foreign entity with FC as its functional currency, on 1 January 20.25, for FC3 000 and, as a result, obtained significant influence over A Ltd from that date.
- 3 P Ltd accounts for investments in associates at cost in terms of IAS 27.10(a).
- 4 Ignore any effects of taxation.
- 5 The following exchange rates are applicable:

	FC1,00 = ZAR
1 January 20.25	2,00
30 November 20.25	2,80
Average for period	2,50
31 December 20.25	3,00

The journal entry in the **separate accounting records of P Ltd** would be as follows:

		Dr R	Cr R
J1	1 January 20.25		
	Investment in associate (SFP) (FC3 000 × R2,00) Bank (SFP) Initial recognition of investment in associate at the spot exchange rate	6 000	6 000
J2	30 November 20.25		
	Bank (SFP) (FC800 × 30% × R2,80) Dividend received (P/L) Recognition of dividend received	672	672



Comments

The dividend received and paid will be translated at the **spot exchange rate** on the date of payment.

Solution 15.5

The consolidated financial statements, incorporating the results of A Ltd in accordance with the equity method, for the year ended 31 December 20.25 are prepared as follows:

P LTD GROUP	
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.25	
ASSETS	
Non-current assets	
Property, plant and equipment (P)	139 000
Investment in associate (FC3 210 × R3,00)	9 630
	148 630
Current assets	
Inventories (P)	50 000
Total assets	R198 630
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital (P)	10 000
Retained earnings	120 453
Other components of equity (FCTR)	3 177
	133 630
Non-controlling interests	25 000
Total equity	158 630
Non-current liabilities	
Trade and other payables (P)	40 000
Total equity and liabilities	R198 630

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.25	
Profit (P)	199 328
Share of profit of associate (FC1 500 × 30% × R2,50)	1 125
Profit before tax	200 453
Income tax expense (P)	(94 000)
PROFIT FOR THE YEAR	106 453
Other comprehensive income	
Items that may be reclassified to profit or loss	
Share of other comprehensive income of associate (FCTR)	3 177
Other comprehensive income for the year, net of tax	3 177
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R109 630
Profit attributable to:	
Owners of the parent (balancing)	91 453
Non-controlling interests	15 000
	R106 453
Total comprehensive income attributable to:	
Owners of the parent (balancing)	94 630
Non-controlling interests	15 000
	R109 630

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.25						
	Share capital	Retained earnings	FCTR	Total	NCI	Total equity
Balance at 1 Jan 20.25	10 000	*79 000	–	89 000	10 000	99 000
Changes in equity for 20.25						
Dividends	–	* (50 000)	–	(50 000)	–	(50 000)
Total comprehensive income for the year:						
Profit for the year	–	91 453	–	91 453	15 000	106 453
Other comprehensive income	–	–	3 177	3 177	–	3 177
Balance at 31 Dec 20.25	R10 000	@ R120 453	R3 177	R133 630	R25 000	R158 630

FCTR = Foreign currency translation reserve

NCI = Non-controlling interests

* Only P

25 000 – 15 000 = 10 000

@ Test: 120 000(P) + 453(A) = 120 453

Calculations

C1 Analysis of owners' equity of A Ltd

	100% FC	30% FC	Rate	At 30% R	Since 30% R
i At acquisition					
Share capital	1 000	300	R2,00	600	
Retained earnings	7 000	2 100	R2,00	4 200	
Net asset value	8 000	2 400		4 800	
Investment in A Ltd		(3 000)	R2,00	(6 000)	
Goodwill		(600)	R2,00	(1 200)	
ii Since acquisition					
• Current year:					
Profit for the year	1 500	450	R2,50 (average)		1 125
Dividends	(800)	(240)	R2,80		(672)
Exchange differences on translation (OCI)	700	210			453
		¹ FC3 210	R3,00		² 3 177
					R9 630

(1) FC3 000 + FC210

(2) R9 630 – R453 – R6 000

**Comments**

The difference between translating a foreign subsidiary and a foreign associate is that when the foreign operation is an associate, the net assets of the associate are **not** translated to the presentation currency but rather the “investment in associate” balance (being the initial investment and since acquisition reserves of the associate). This is because associates are accounted for using the equity method. According to the equity method, the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor’s share of the investee’s net assets.

The following steps are followed in calculating the exchange differences on translation of R3 177 for the 20.25 financial year:

Step 1: Recognise the initial investment in A Ltd at cost translated using the spot rate at acquisition of R6 000.

Step 2: Recognise the post-acquisition change in P Ltd’s share of the A Ltd’s net assets translated at the appropriate rate (refer to paragraph 15.8). Increase the investment in A Ltd with the share of profit of R1 125 and reduce the investment in A Ltd with the dividend received of R672.

Step 3: Calculate P Ltd’s investment in A Ltd (at P Ltd’s 30% share in A Ltd) in the **foreign currency** at the reporting date of FC3 210. Translate the foreign currency investment in A Ltd using the spot rate at the reporting date, $FC3\ 210 \times R3 = R9\ 630$.

Step 4: Account for the difference between step 3 (R9 630) and the sum of step 1 and 2 R6 453 ($6\ 000 + 1\ 125 - 672$) (which is already included in the investment in A Ltd balance) to ensure the investment in A Ltd is stated at the spot rate at the reporting date. Refer to J3 below. The current year’s restatement difference is recognised in other comprehensive income as the foreign currency exchange reserve (FCTR).

When equity accounting, the **goodwill is not accounted for separately** as it is included in the initial investment in A Ltd. Therefore, no additional exchange difference on translation adjustment is required for goodwill, as is the case for subsidiaries.

C2 Pro forma consolidation journal entries

		Dr R	Cr R
	31 December 20.25		
J1	Investment in associate (SFP) ($FC1\ 500 \times 30\% \times R2,50$) Share of profit of associate (P/L) Recognition of share of profit of foreign associate	1 125	1 125
J2	Dividend received (P/L) Investment in associate (SFP) Elimination of intragroup dividend received	672	672
J3	Investment in associate (SFP) Share of other comprehensive income of associate – FCTR (OCI) Remeasure the investment in associate to closing rate	3 177	3 177

15.13 Disposal of a foreign operation

On the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, recognised in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss (as a reclassification adjustment) when the consolidated

gain or loss on disposal is recognised. **IAS 1 Presentation of Financial Statements** addresses the issue of reclassification adjustments.

The following are accounted for as a disposal of a foreign operation:

- ☐ the disposal of an entity's entire interest in a foreign operation;
- ☐ the partial disposal of an entity's interest in a foreign operation (an interest in the former subsidiary, associate or jointly controlled entity is retained) and:
 - the entity **loses control** of a subsidiary that includes a foreign operation;
 - the entity **loses significant influence** over an associate that includes a foreign operation; and
 - the entity **loses joint control** over a jointly controlled entity that includes a foreign operation.

Therefore, on the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation shall be reclassified from equity to profit or loss as a reclassification adjustment. When disposing of a foreign subsidiary, the cumulative amount of the exchange differences relating to that foreign operation that **have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss**. This means that the cumulative amount of exchange differences reclassified to profit or loss will be done on a net basis (only the amount attributable to the owners of the **parent** and not the full amount), net of the non-controlling interests. Example 15.6 illustrates this principle.

An entity can also partially dispose of its interest in a foreign operation **without losing control, significant influence or joint control**. This would be any reduction in an entity's ownership in a foreign operation, except those reductions referred to above as disposals. Partial disposals therefore include, amongst others, changes in a parent's ownership interest in a subsidiary that **do not result in a loss of control**.

Upon the partial disposal of a subsidiary that includes a foreign operation, the entity is required to **re-attribute the proportionate share of the cumulative amount of the exchange differences to the non-controlling interests** in that foreign operation. Example 15.6 below illustrates this principle. In any other partial disposal of a foreign operation (e.g., a branch), the entity is required to reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences.

An entity may dispose (or partially dispose) of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

Example 15.6

**Disposal of a foreign operation resulting in a loss of control
(NCI is measured at fair value at the acquisition date)**

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27

	P Ltd and sub- sidiaries (consoli- dated) R	S Ltd FC
ASSETS		
Property, plant and equipment	500 000	7 000
Investment in S Ltd – 4 000 shares at cost price	50 000	–
Inventory	190 000	12 750
Total assets	R740 000	FC19 750
EQUITY AND LIABILITIES		
Share capital (400 000/10 000 shares)	400 000	10 000
Retained earnings	240 000	9 750
Non-controlling interests	100 000	–
Total equity and liabilities	R740 000	FC19 750

**STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.27**

	P Ltd and sub- sidiaries (consoli- dated) R	S Ltd FC
Revenue	500 000	30 000
Cost of sales	(210 000)	(20 000)
Gross profit	290 000	10 000
Other income (gain on disposal of interest)	36 000	–
Profit before tax	326 000	10 000
Income tax expense	(146 000)	(5 250)
PROFIT FOR THE YEAR	180 000	4 750
Other comprehensive income	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R180 000	FC4 750
Total comprehensive income attributable to:		
Owners of the parent	140 000	4 750
Non-controlling interests	40 000	–
	R180 000	FC4 750

EXTRACT FROM STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd and sub-sidiaries (consoli-dated) R	S Ltd FC
Balance at 1 January 20.27	150 000	7 500
Changes in equity for 20.27		
Total comprehensive income for the year:		
Profit for the year	140 000	4 750
Dividend paid: 31/12/20.27	(50 000)	(2 500)
Balance at 31 December 20.27	R240 000	FC9 750

- 1 P Ltd is a South African company and has the South African Rand (ZAR) as its functional currency. P Ltd purchased 8 000 shares in S Ltd, a foreign subsidiary with FC as its functional currency, on 1 January 20.23 for R100 000. The analysis of owners' equity of S Ltd, calculated correctly up to 31 December 20.26, is as follows:

Analysis of owners' equity of S Ltd

	100% FC	Rate	100% R	At 80% R	Since 80% R	NCI 20% R
i At acquisition						
Share capital	10 000	R8,00	80 000	64 000		16 000
Retained earnings	2 500	R8,00	20 000	16 000		4 000
	12 500	R8,00	100 000	80 000		20 000
Equity represented by goodwill – Parent and NCI	3 250	R8,00	26 000	20 000		6 000
Consideration and NCI	15 750		126 000	100 000		26 000
ii Since acquisition						
• Current year:						
Retained earnings	5 000	(average)	42 250		33 800	8 450
FCTR (excluding goodwill)			15 250		12 200	3 050
FCTR (goodwill only)			3 250		2 600	650
31 December 20.26	20 750	R9,00	186 750		48 600	38 150

- 2 On 31 March 20.27, P Ltd disposed of 4 000 shares in S Ltd for R86 000. From that date, P Ltd classified the investment in S Ltd as a financial asset under IFRS 9 in its separate financial statements and P Ltd recognised fair value adjustments in the mark-to-market reserve. The fair value of the remaining investment in S Ltd was R80 000 at the date of disposal of the interest and remained unchanged at year-end.
- 3 S Ltd's profit and tax for 20.27 accrued evenly.

- 4 P Ltd accounted for the investment in S Ltd at cost in its separate financial statements.
- 5 P Ltd elected to measure the non-controlling interest at fair value at the date of acquisition.
- 6 The disposal of the interest in the subsidiary did not comply with the criteria of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations** until the date of disposal thereof and S Ltd does not represent a separate major line of business or geographical area of the group.
- 7 None of P Ltd's subsidiaries declared or paid a dividend during the 20.27 financial year.
- 8 The company tax rate is 27%. Ignore capital gains tax consequences. Assume there are no deferred tax consequences on the exchange differences on translation of the foreign operation.
- 9 The following exchange rates are applicable:

	FC1,00 = ZAR
31/12/20.26	9,00
Average 1/1/20.27–31/3/20.27	9,20
31/3/20.27	9,50
Average 1/4/20.27–31/12/20.27	9,80
31/12/20.27	10,00

Solution 15.6

The consolidated financial statements for the year ended 31 December 20.27 are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (P and other subsidiaries)	500 000
Equity investment	80 000
	580 000
Current assets	
Inventory (P and other subsidiaries)	190 000
Total assets	R770 000
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital (P)	400 000
Retained earnings	270 000
Other components of equity	-
	670 000
Non-controlling interests (i.r.o. other subsidiaries)	100 000
Total equity	770 000
Total equity and liabilities	R770 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27	
Revenue (500 000(P) + 69 000(S)(J1))	569 000
Cost of sales (210 000(P) + 46 000(S)(J1))	(256 000)
Gross profit (290 000(P) + 23 000(S))	313 000
Other income (71(gain on disposal of interest)(J1) + 23 385(reclassification adjustment)(J2))	23 456
Profit before tax	336 456
Income tax expense (146 000(P) + 12 070(S)(J1))	(158 070)
PROFIT FOR THE YEAR	178 386
Other comprehensive income:	
Items that may be reclassified subsequently to profit or loss:	
Exchange differences on translating foreign operations (9 106 + 1 625)	10 731
Less: Reclassification adjustment (J2)	(23 385)
Other comprehensive income for the year, net of tax	(12 654)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R165 732
Profit attributable to:	
Owners of the parent (balancing)	136 200
Non-controlling interests (40 000(other) + 2 186(S)(J1))	42 186
	R178 386
Total comprehensive income attributable to:	
Owners of the parent (balancing)	121 400
Non-controlling interests (42 186 + 1 821(S)(J1) + 325(S)(J1))	44 332
	R165 732

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27						
	Share capital	Retained earnings	FCTR	Total	NCI	Total equity
Balance at 1 Jan 20.27	400 000	¹ 183 800	² 14 800	598 600	³ 98 150	696 750
Changes in equity for 20.27						
Dividends	–	(50 000)	–	(50 000)	–	(50 000)
Total comprehensive income for the year:						
Profit for the year	–	136 200	–	136 200	42 186	178 386
Other comprehensive income	–	–	⁴ (14 800)	(14 800)	⁵ 2 146	(12 654)
Derecognition of non-controlling interests	–	–	–	–	(42 482)	(42 482)
Balance at 31 Dec 20.27	R400 000	R270 000	⁶ R-	R670 000	R100 000	R770 000

FCTR = Foreign currency translation reserve

NCI = Non-controlling interests

(1) $150\,000(P) + 33\,800(S) = 183\,800$

(2) $12\,200 + 2\,600 = 14\,800$

(3) $100\,000 + 42\,482 - 2\,146 - 42\,186 = 98\,150$

(4) $7\,285 + 1\,300 - (7\,285 + 1\,300 + 14\,800) = 14\,800$

(5) $1\,821 + 325 = 2\,146$

(6) The cumulative amount of the exchange differences has been reclassified from equity to profit or loss as a reclassification adjustment, on a net basis, in terms of IAS 21.48 and IAS 21.48B.

Calculations

C1 Analysis of owners' equity of S Ltd

	100% FC	Rate	100% R	At 80% R	Since 80% R	NCI 20% R
i At acquisition						
Share capital	10 000	R8,00	80 000	64 000		16 000
Retained earnings	2 500	R8,00	20 000	16 000		4 000
	12 500	R8,00	100 000	80 000		20 000
Equity represented by goodwill –Parent and NCI	3 250	R8,00	26 000	20 000		6 000
Consideration and NCI	15 750		126 000	100 000		26 000
ii Since acquisition						
• To beginning of current year:						
Retained earnings	5 000		42 250		33 800 RE	8 450
FCTR (excluding goodwill)			15 250		12 200FCTR	3 050
FCTR (goodwill only)			3 250		2 600FCTR	650
31 December 20.26	20 750	R9,00	186 750		48 600	38 150
• Current year:						
Profit: first three months	1 188	R9,20	10 930		8 744 RE	2 186
Exchange differences on translation (excluding goodwill)			9 106		7 285 FCTR	1 821
Exchange differences on translation (goodwill only)			1 625		1 300 FCTR	325
31 March 20.27	21 938	R9,50	208 411		65 929 42 544 RE 23 385FCTR	42 482
iii Loss of control over subsidiary						
Derecognise assets and liabilities (IFRS 10.B98)	(21 938)		(208 411)	(100 000)	(65 929)	(42 482)
	–		–	–	–	–

(1) $FC4\ 750/12 \times 3 = FC1\ 188$

**Comments**

- a If a parent loses control, as is the case with S Ltd here, the gain or loss on disposal of interest would be calculated as follows using IFRS 10.B98:

Derecognise assets (incl. goodwill) and liabilities on date control is lost	(208 411)
Derecognise non-controlling interest	42 482
Carrying amount of P Ltd's interest in S Ltd lost (100 000 + 65 929)	(165 929)
Recognise consideration received	86 000
Fair value of investment retained	80 000
Gain (consolidated) recognised in profit or loss	<u>R71</u>

- b By means of the relevant amounts (as contained in the analysis of the ownership interest of S Ltd), the gain on disposal of shares in S Ltd can be analysed as follows:

Proceeds on disposal of interest	86 000
Attributable net assets disposed of [(208 411 – 26 000(GW)) × 40%]	(72 964)
	13 036
Goodwill realised (only for the parent company) (20 000 × 40/80)	(10 000)
	3 036
Remeasurement gain (80 000 versus (72 965 + 10 000))	(2 965)
Capital (consolidated) gain on disposal of the interest	<u>R71</u>

- c In this example, S Ltd had post-acquisition reserves comprising FCTR and retained earnings. Any balance of the FCTR would, on the date of the disposal, be **reclassified through other comprehensive income to profit or loss** on a net basis. See journal J2. If S Ltd had other post-acquisition reserves, any balance of these reserves would, on the date of the disposal, be transferred to retained earnings (e.g. revaluation surplus or mark-to-market reserve).

C3 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	100 000
Amount of non-controlling interest: IFRS 3.32(a)(ii)	26 000
	<u>126 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(100 000)
Goodwill (parent and NCI)	<u>R26 000</u>

C4 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Investment in S Ltd (SFP)	30 000	
	Gain on disposal of interest (P/L) (per P) (comment (a))	36 000	
	Cost of sales (P/L) ($20\,000 \times 3/12 \times R9,20$)	46 000	
	Non-controlling interest (P/L) (first 3 months)	2 186	
	Income tax expense (P/L) ($5\,250 \times 3/12 = 1\,312 \times R9,20$)	12 070	
	Non-controlling interest (OCI) ($1\,821 + 325$)	2 146	
	Revenue (P/L) ($30\,000 \times 3/12 \times R9,20$)		69 000
	Retained earnings – Beginning of year (SCE) (opening balance)		33 800
	FCTR – Beginning of year (SCE)		14 800
	Gain on disposal of interest (P/L) (group context)		71
	Exchange differences on translation of foreign operation (OCI) ($9\,106 + 1\,625$)		10 731
	Consolidation of subsidiary S Ltd and recognition of disposal of interest at group level		
J2	Reclassification adjustment (OCI) (comment (b))	23 385	
	Gain on disposal of interest (P/L)		23 385
	Reclassification of realised exchange gains to P/L		
J3	Non-controlling interests (SCE) (derecognised)	42 482	
	Non-controlling interests – Beginning of year (SCE) (opening balance in equity)		38 150
	Non-controlling interests (SCE) (current year's interest in profit)		2 186
	Non-controlling interests (SCE) ($1\,821 + 325$) (current year's exchange differences on translation)		2146
	Accounting for various line items of non-controlling interests in equity for S Ltd (comment (c))		



Comments

- The gain on disposal in the separate accounting records of P Ltd could also be calculated as $86\,000 - (100\,000 \times 4\,000/8\,000) = 36\,000$ profit.
- $12\,200 + 2\,600 + 7\,285 + 1\,300 = 23\,385$ Done on a net basis (only the amount attributable to the owners of the **parent** and not the full amount) in terms of IAS 21.48B. Hence, no NCI is recognised in this journal entry.
- All entries in J3 are made against the same ledger account with no net effect. Thus, it may be argued that J3 is not needed. J3 only assists in preparing the various line items for the non-controlling interests in the consolidated statement of changes in equity.

Example 15.7	Partial disposal of an interest in a foreign subsidiary with no change in the status as the subsidiary remains a subsidiary (control is not lost) (NCI is measured at its proportionate share of the acquiree’s identifiable net assets at the acquisition date)
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STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27		
	P Ltd and other subsidiaries (consolidated)	S Ltd
	R	FC
ASSETS		
Property, plant and equipment	500 000	7 000
Investment in S Ltd – 6 000 shares at cost price	60 000	–
Inventory	167 000	15 250
Total assets	R727 000	FC22 250
EQUITY AND LIABILITIES		
Share capital (400 000/10 000 shares)	400 000	10 000
Retained earnings	227 000	12 250
Non-controlling interests	100 000	–
Total equity and liabilities	R727 000	FC22 250

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.27		
	P Ltd and subsidiaries (consolidated)	S Ltd
	R	FC
Revenue	500 000	30 000
Cost of sales	(210 000)	(20 000)
Gross profit	290 000	10 000
Other income (gain on disposal of interest)	23 000	–
Profit before tax	313 000	10 000
Income tax expense	(146 000)	(5 250)
PROFIT FOR THE YEAR	167 000	4 750
Other comprehensive income	–	–
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R167 000	FC4 750
Total comprehensive income attributable to:		
Owners of the parent	127 000	4 750
Non-controlling interests	40 000	–
	R167 000	FC4 750

EXTRACT FROM STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27		
	Retained earnings	
	P Ltd and subsidiaries (consolidated)	S Ltd
	R	FC
Balance at 1 January 20.27	150 000	7 500
Changes in equity for 20.27		
Total comprehensive income for the year:		
Profit for the year	127 000	4 750
Dividend paid: 31/12/20.27	(50 000)	–
Balance at 31 December 20.27	R227 000	FC12 250

- 1 P Ltd is a South African company and has the South African Rand (ZAR) as its functional currency. P Ltd purchased 8 000 shares in S Ltd, a foreign entity with FC as its functional currency, for R80 000. From this date, P Ltd had control over S Ltd

in accordance with IFRS 10. The analysis of owners' equity of S Ltd, calculated correctly up to 31 December 20.26, is as follows:

Analysis of owners' equity of S Ltd

	(FC) 100%	Rate	(R) 100%	(R) 80% At	(R) 80% Since	(R) 20% NCI
i At acquisition						
Share capital	10 000	R8,00	80 000	64 000		16 000
Retained earnings	2 500	R8,00	20 000	16 000		4 000
	12 500	R8,00	100 000	80 000		20 000
Equity represented by goodwill – Parent	–		–	–		–
Consideration and NCI	12 500		100 000	80 000		20 000
ii Since acquisition						
• Current year:						
Retained earnings	5 000	(average)	42 250		33 800	8 450
FCTR			15 250		12 200	3 050
31 December 20.26	FC17 500	R9,00	R157 500		¹ R46 000	R31 500

(1) $33\,800(\text{RE}) + 12\,200(\text{FCTR}) = 46\,000$

- On 31 March 20.27, P Ltd disposed of 2 000 shares in S Ltd for R43 000.
- S Ltd's profit and taxation accrued evenly for 20.27.
- P Ltd accounted for the investment in S Ltd at cost in its separate financial statements.
- P Ltd elected to measure the non-controlling interest at its proportionate share of the acquiree's identifiable net assets at the acquisition date.
- The disposal of the interest in the subsidiary did not comply with the criteria of **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations**.
- None of P Ltd's subsidiaries declared or paid a dividend during the 20.27 financial year.
- The non-controlling interest opening balance on 1 January 20.27 in the statement of changes in equity for all other subsidiaries (excluding S Ltd) was R60 000.
- Ignore any effects of taxation.
- The following exchange rates are applicable:

	FC1,00 = ZAR
31/12/20.26	9,00
Average 1/1/20.27–31/3/20.27	9,20
31/3/20.27	9,50
Average 1/4/20.27–31/12/20.27	9,80
31/12/20.27	10,00

Solution 15.7

The consolidated financial statements for the year ended 31 December 20.27 are prepared as follows:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.27	
ASSETS	
Non-current assets	
Property, plant and equipment (500 000(P) + (7 000 × R10,00)(S))	570 000
Current assets	
Inventory (167 000(P) + (15 250 × R10,00)(S))	319 500
Total assets	R889 500
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital (P)	400 000
Retained earnings	267 489
Other components of equity (12 364 + 20 648)	33 012
	700 501
Non-controlling interests	188 999
Total equity	889 500
Total equity and liabilities	R889 500

P LTD GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS
AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20.27

Revenue (500 000(P) + 289 500(S) (see comment below))	789 500
Cost of sales (210 000(P) + 193 000(S)) (see comment below)	(403 000)
Gross profit	386 500
Other income (23 000(P) – 23 000(J5))	–
Profit before tax	386 500
Income tax expense (146 000 + 50 662) (see comment below)	(196 662)
PROFIT FOR THE YEAR	R189 838
Other comprehensive income:	
Items that may be reclassified subsequently to profit or loss:	
Exchange differences on translating foreign operations (9 106(analysis) + 10 056(analysis))	19 162
Other comprehensive income for the year, net of tax	19 162
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R209 000
Profit attributable to:	
Owners of the parent	133 689
Non-controlling interests (40 000(other) + 2 186(analysis) + 13 963(analysis))	56 149
	R189 838
Total comprehensive income attributable to:	
Owners of the parent	147 008
Non-controlling interests (56 149 + 1 821(analysis) + 4 022(analysis))	61 992
	R209 000



Comment

Conversion statement of profit or loss and other comprehensive income of S Ltd for the year ended 31 December 20.27

		First 3 months (R9,20)	Last 9 months (R9,80)	TOTAL
	FC	R	R	R
Revenue	30 000	69 000	220 500	289 500
Cost of sales	(20 000)	(46 000)	(147 000)	(193 000)
Gross profit	10 000	23 000	73 500	96 500
Income tax expense	(5 250)	(12 070)	(38 592)	(50 662)
	FC4 750	R10 930	R34 908	R45 838

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.27							
	Share capital	Changes in owner-ship	Retained earnings	FCTR	Total	NCI	Total equity
Balance at 1 Jan 20.27	400 000	–	¹ 183 800	12 200	596 000	² 91 500	687 500
Changes in equity for 20.27							
Dividends	–	–	(50 000)	–	(50 000)	–	(50 000)
Total comprehensive income for the year:							
Profit for the year	–	–	133 689	–	133 689	56 149	189 838
Other comprehensive income	–	–	–	⁴ 13 319	13 319	³ 5 843	19 162
Disposal of interest (J5)	–	12 364	–	–	12 364	30 636	43 000
Transfer of FCTR (J5)	–	–	–	(4 871)	(4 871)	4 871	–
Balance at 31 Dec 20.27	R400 000	R12 364	R267 489	R20 648	R700 501	R188 999	R889 500

FCTR = Foreign currency translation reserve

NCI = Non-controlling interests

(1) 150 000(P) + 33 800(S) = 183 800

(2) 31 500(S) + 60 000(other subsidiaries) = 91 500

(3) 61 992 – 56 149 = 5 843

(4) 19 162(OCI) – 5 843 = 13 319 or 19 162(OCI) – 1 821(NCI) – 4 022(NCI) = 13 319

Calculations

C1 Analysis of owners' equity of S Ltd

	100% FC	Rate	100% R	(80%–60%)		(20%– 40%)
				At R	Since R	NCI R
i At acquisition						
Share capital	10 000	R8,00	80 000	64 000		16 000
Retained earnings	2 500	R8,00	20 000	16 000		4 000
	12 500	R8,00	100 000	80 000		20 000
Equity represented by goodwill – Parent	–		–	–		–
Consideration and NCI	12 500		100 000	80 000		20 000
ii Since acquisition						
• To beginning of current year:						
Retained earnings	5 000		42 250		33 800	8 450
FCTR			15 250		12 200	3 050
31 December 20.26	17 500	R9,00	157 500		46 000	31 500
• Current year:						
Profit: first three months	¹ 1 188	R9,20	10 930		8 744	2 186
Exchange differences on translation (OCI)			9 106		7 285	1 821
31 March 20.27	18 688	R9,50	177 536		62 029	35 507
Sale of 2 000 shares ²				(20 000)	(15 507)	35 507
					46 522	71 014
Profit: last nine months	³ 3 562	R9,80	34 908		20 945	13 963
Exchange differences on translation (OCI)			10 056		6 034	4 022
31 December 20.27 ⁴	FC22 250	R10,00	R222 500		R73 501	R88 999

(1) $FC4\ 750/12 \times 3 = FC1\ 188$ (2) $80\ 000 \times 20/80 = 20\ 000$ At $(33\ 800 + 8\ 744) \times 20/80 = 10\ 636$ RE $(12\ 200 + 7\ 285) \times 20/80 = 4\ 871$ FCTR $10\ 636 + 4\ 871 = 15\ 507$

Equity acquired from parent = 35 507

(3) $FC4\ 750 - FC1\ 188 = FC3\ 562$ (4) $(33\ 800 + 8\ 744 - 10\ 636 + 20\ 945) = 52\ 853$ RE $(12\ 200 + 7\ 285 - 4\ 871 + 6\ 034) = 20\ 648$ FCTRTotal Since = $52\ 853 + 20\ 648 = 73\ 501$

	Comments a The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (from the perspective of the NCI): <table> <tr> <td>Fair value of the consideration paid by NCI</td><td>43 000</td></tr> <tr> <td>Amount by which the non-controlling interests are adjusted (reserves acquired from parent – see below)</td><td>(35 507)</td></tr> <tr> <td>NCI after transaction ($177\,536 \times 40\%$)</td><td>71 014</td></tr> <tr> <td>NCI before transaction ($177\,536 \times 20\%$)</td><td>(35 507)</td></tr> <tr> <td></td><td><u>7 493</u></td></tr> <tr> <td>Add: FCTR already treated as equity</td><td>4 871</td></tr> <tr> <td>Amount to be recognised directly in equity</td><td><u>R12 364</u></td></tr> </table> b The amount for the change in ownership recognised in equity can also be calculated as follows (from the change in the parent's interest): <table> <tr> <td>Fair value of the consideration received by the parent</td><td>43 000</td></tr> <tr> <td>Equity relinquished to NCI</td><td>(35 507)</td></tr> <tr> <td>Historic fair value of shares disposed of</td><td>(20 000)</td></tr> <tr> <td>Attributable post-acquisition equity disposed of:</td><td></td></tr> <tr> <td> Retained earnings</td><td>(10 636)</td></tr> <tr> <td> FCTR</td><td>(4 871)</td></tr> <tr> <td></td><td><u>7 493</u></td></tr> <tr> <td>Add: FCTR already treated as equity</td><td>4 871</td></tr> <tr> <td>Amount to be recognised directly in equity/Capital gain on disposal of interest (in group context)</td><td><u>R12 364</u></td></tr> </table> c Alternatively, the amount can also be calculated as follows: <table> <tr> <td>Proceeds on disposal of interest</td><td>43 000</td></tr> <tr> <td>Attributable net assets disposed</td><td>(35 507)</td></tr> <tr> <td></td><td><u>7 493</u></td></tr> <tr> <td>Add: FCTR already treated as equity</td><td>4 871</td></tr> <tr> <td>Amount to be recognised directly in equity/Capital gain on disposal of interest (in group context)</td><td><u>R12 364</u></td></tr> </table>	Fair value of the consideration paid by NCI	43 000	Amount by which the non-controlling interests are adjusted (reserves acquired from parent – see below)	(35 507)	NCI after transaction ($177\,536 \times 40\%$)	71 014	NCI before transaction ($177\,536 \times 20\%$)	(35 507)		<u>7 493</u>	Add: FCTR already treated as equity	4 871	Amount to be recognised directly in equity	<u>R12 364</u>	Fair value of the consideration received by the parent	43 000	Equity relinquished to NCI	(35 507)	Historic fair value of shares disposed of	(20 000)	Attributable post-acquisition equity disposed of:		Retained earnings	(10 636)	FCTR	(4 871)		<u>7 493</u>	Add: FCTR already treated as equity	4 871	Amount to be recognised directly in equity/Capital gain on disposal of interest (in group context)	<u>R12 364</u>	Proceeds on disposal of interest	43 000	Attributable net assets disposed	(35 507)		<u>7 493</u>	Add: FCTR already treated as equity	4 871	Amount to be recognised directly in equity/Capital gain on disposal of interest (in group context)	<u>R12 364</u>
Fair value of the consideration paid by NCI	43 000																																										
Amount by which the non-controlling interests are adjusted (reserves acquired from parent – see below)	(35 507)																																										
NCI after transaction ($177\,536 \times 40\%$)	71 014																																										
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Retained earnings	(10 636)																																										
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Attributable net assets disposed	(35 507)																																										
	<u>7 493</u>																																										
Add: FCTR already treated as equity	4 871																																										
Amount to be recognised directly in equity/Capital gain on disposal of interest (in group context)	<u>R12 364</u>																																										

C2 Proof of calculation of goodwill of S Ltd in terms of IFRS 3.32

Consideration transferred at acquisition date: IFRS 3.32(a)(i)	80 000
Amount of non-controlling interest: IFRS 3.32(a)(ii)	20 000
	<u>100 000</u>
Net of the identifiable assets acquired and liabilities assumed at acquisition date: IFRS 3.32(b)	(100 000)
Goodwill (parent)	<u>–</u>

C3 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Share capital (SCE) Retained earnings (SCE) Goodwill (SFP) Investment in S Ltd (SFP) Non-controlling interests (SCE) Main elimination journal entry at acquisition	80 000 20 000 –	80 000 20 000
J2	Retained earnings – Opening balance (SCE) FCTR – Opening balance (SCE) Non-controlling interests (SCE) Recognition of of non-controlling interests' portion of retained earnings & FCTR	8 450 3 050	11 500
J3	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of of non-controlling interests' portion of current year's profit at 20%	2 186	2 186
J4	Non-controlling interests (OCI) Non-controlling interests (SCE) Recognition of of non-controlling interests' portion of exchange differences on translation at 20%	1 821	1 821
J5	Investment in S Ltd (SFP) Gain on disposal of interest (P)(P/L) FCTR (SCE) Changes in ownership (SCE) Non-controlling interests (SCE) (20 000(At) + 10 636(RE) + 4 871(FCTR)) Pro forma correction of group gain on disposal	20 000 23 000 4 871	12 364 35 507
J6	Non-controlling interests (P/L) Non-controlling interests (SCE) Recognition of of non-controlling interests' portion of current year's profit at 40%	13 963	13 963
J7	Non-controlling interests (OCI) Non-controlling interests (SCE) Recognition of of non-controlling interests' portion of exchange differences on translation at 40%	4 022	4 022

	Comment The following alternative journals could also have been prepared for J5:		
	Alternative 1		
		Dr R	Cr R
	Investment in S Ltd (SFP)	20 000	
	Gain on disposal of interest (P/L)	23 000	
	Non-controlling interests (SCE)		30 636
	Change in Ownership (SCE)		12 364
	FCTR (SCE)	4 871	
	Non-controlling interests (SCE) (IAS 21.48C)		4 871
	Pro forma correction of group gain on disposal		
Alternative 2			
		Dr R	Cr R
	Investment in S Ltd (SFP)	20 000	
	Gain on disposal of interest (P/L)	23 000	
	Non-controlling interests (SCE)		35 507
	Change in Ownership (SCE)		7 493
	FCTR (SCE)	4 871	
	Change in Ownership (SCE)		4 871
	Pro forma correction of group gain on disposal		

Self-assessment question

Question 15.1

Eastern Ltd is a South African company and has the South African Rand (ZAR) as its functional currency. You have commenced with the final audit of Eastern Ltd for the financial reporting period ended 30 June 20.28.

A few weeks into the engagement, a few unresolved accounting issues have arisen. These issues need to be dealt with by you and have been summarised below. Separate/Individual financial statements of group companies are included in the appendix.

Information relevant to the consolidation

Eastern Ltd acquired its 80% controlling interest in Travel Ltd, a foreign entity, on 1 July 20.27 for LSL3 million when the equity of Travel Ltd consisted of the following:

	LSL
Share capital (100 000 shares)	100 000
Retained earnings	1 254 687
Revaluation surplus	1 228 125
Equity	<u>2 582 812</u>

The functional currency of Travel Ltd is the Lesotho Loti (LSL). The fair value of Travel Ltd ordinary shares at the acquisition date amounted to LSL36,00 per share.

All the assets and liabilities of Travel Ltd were deemed to be fairly valued at the acquisition date, except for a factory building. No additional assets, liabilities or contingent liabilities were identified at the acquisition date.

It was determined at the acquisition date that a factory building, owned by Travel Ltd, appeared to be undervalued. Travel Ltd is entitled to a capital allowance on the building, which is the same as the depreciation on the building. The building is measured according to the revaluation model in the individual financial statements of Travel Ltd.

Details of the building are as follows:

	LSL'000
Revalued carrying amount (1 July 20.27)	3 200
Fair value (1 July 20.27)	4 000

The directors of Travel Ltd have no intention of disposing of the building in the near future. The building is depreciated on the straight-line basis over its estimated remaining useful life of 10 years on 1 July 20.27. There is no residual value for the purposes of depreciation. The factory building was revalued at the reporting date 30 June 20.28 in the individual financial statements of Travel Ltd.

Eastern Ltd disposed of a 20% interest in Travel Ltd on 30 June 20.28 for R250 000 cash. Eastern Ltd therefore now holds a 60% interest in Travel Ltd after the date of disposal and retains control over the board of directors of Travel Ltd. The accountant was unsure how to account for the disposal in the separate financial statements and therefore recorded the proceeds in a suspense account.

Additional information

- ☐ The South African tax rate of companies is 27% and the capital gains tax inclusion rate is 80%.
- ☐ The applicable tax rate of companies is 25% in Lesotho.
- ☐ The following exchange rates are applicable:

	LSL1,00 = ZAR
1 July 20.27	0,50
30 June 20.28	0,70
Average for the 20.28 financial reporting period	0,60

Information about group accounting policies

- ☐ The Eastern Ltd Group elected to measure the non-controlling interests at fair value at the acquisition date.
- ☐ The Eastern Ltd Group measures factory buildings according to the cost model in terms of **IAS 16 Property, Plant and Equipment**.
- ☐ Eastern Ltd accounts for investments in subsidiaries at cost in accordance with IAS 27.10(a) in its separate financial statements.

Required

Provide the pro forma journal entries that should be processed in respect of Travel Ltd in the **consolidated** annual financial statements of Eastern Ltd for the financial reporting period ended 30 June 20.28.

APPENDIX
EXTRACTS FROM SEPARATE/INDIVIDUAL FINANCIAL STATEMENTS
OF GROUP COMPANIES
FOR THE YEAR ENDED 30 JUNE 20.28

STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 20.28		
	Eastern Ltd	Travel Ltd
	R'000	LSL'000
ASSETS		
Non-current assets		
Property, plant and equipment	2 085	4 000
Equity investments at fair value (through other comprehensive income)	8 500	–
Investment in subsidiary: Travel Ltd	1 500	–
Current assets		
Inventory	–	300
Trade receivables	5 800	280
Cash and cash equivalents	2 800	435
Total assets	20 685	5 015

STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 20.28		
	Eastern Ltd	Travel Ltd
	R'000	LSL'000
EQUITY AND LIABILITIES		
Share capital (1 000 000/100 000 shares)	8 000	100
Revaluation surplus	–	445
Mark-to-market reserve	2 000	–
Retained earnings	5 000	1 778
Total equity	15 000	2 323
Non-current liabilities		
Long-term borrowings	4 000	2 155
Deferred tax	350	120
Total non-current liabilities	4 350	2 275
Current liabilities		
Trade and other payables	985	280
Suspense account: Proceeds on disposal	250	–
Current tax payable	100	137
Total current liabilities	1 335	417
Total liabilities	5 685	2 692
Total equity and liabilities	20 685	5 015

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.28		
	Eastern Ltd	Travel Ltd
	R'000	LSL'000
Revenue	100	2 000
Cost of sales	(20)	(500)
Gross profit	80	1 500
Other income	2 000	300
Other expenses	(500)	(500)
Finance costs (net)	(700)	(50)
Profit before tax	880	1 250
Income tax expense	(180)	(600)
PROFIT FOR THE YEAR	700	650
Other comprehensive income:		
Items that will not be reclassified to profit or loss, net of tax:		
Gains on equity investments at fair value	300	–
Loss on property revaluation	–	(660)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	1 000	(10)

STATEMENT OF CHANGES IN EQUITY THE YEAR ENDED 30 JUNE 20.28		
	Eastern Ltd	Travel Ltd
	R'000	LSL'000
Retained earnings		
Balance at 1 July 20.27	5 800	1 255
Changes in equity for 20.28		
Total comprehensive income for the year	700	650
Transfer from revaluation surplus (on 30 June)	–	123
Dividend declared and paid (on 30 June)	(1 500)	(250)
Balance at 30 June 20.28	5 000	1 778

Suggested solution 15.1

Pro forma consolidation journal entries for Travel Ltd

		Dr R	Cr R
J1	Factory building (SFP) (LSL800 000 × R0,50) Deferred tax (SFP) (LSL800 000 × 25% × R0,50) Equity at acquisition (SCE) (balancing) Pro forma IFRS 3 remeasurement of factory building at acquisition including tax consequences	400 000	100 000 300 000
J2	Share capital (SCE) (LSL100 000 × R0,50) Retained earnings (SCE) (LSL1 254 687 × R0,50) Revaluation surplus (SCE) (LSL1 228 125 × R0,50) Equity at acquisition (SCE) (J1 above) Goodwill (SFP) Investment in Travel Ltd (SFP) Non-controlling interests (SCE) (at fair value) (20 000 × LSL36 × R0,50) Main elimination journal entry for Travel Ltd at acquisition date	50 000 627 344 614 063 300 000 268 593	1 500 000 360 000
J3	Depreciation (P/L) ((LSL800 000/10 years) × R0,70 (closing spot)) Accumulated depreciation (SFP) Pro forma adjustment of depreciation at group level	56 000	56 000
J4	Deferred tax (SFP) (R56 000 × 25%) Income tax expense (P/L) Tax effect for depreciation adjustment	14 000	14 000
J5	Factory building (SFP) (LSL660 000 × 1/0,75 × R0,70 (closing spot)) Loss on property revaluation (OCI) Elimination of subsequent revaluation done by the subsidiary due to group accounting policy of cost	616 000	616 000
J6	Tax on other comprehensive income (OCI) Deferred tax (SFP) Elimination of tax effect for building revaluation at year-end (R616 000 (J6) × 25%)	154 000	154 000
J7	Retained earnings (SCE) (LSL123 000 × R0,70 (closing spot)) Revaluation surplus (SCE) Reversal of realisation of revaluation surplus to retained earnings	86 100	86 100

continued

		Dr R	Cr R
J8	Goodwill (SFP) (LSL537 186 × (R0,70 – R0,50)) Factory building (SFP) (LSL800 000 × (R0,70 – R0,50)) Deferred tax (SFP) (LSL200 000 × (R0,70 – R0,50)) Exchange differences on translation (OCI) (balancing) Exchange differences on translation due to non-inclusion of pro forma IFRS 3 remeasurement of building and goodwill on pre-consolidation conversion trial balance	107 437 160 000 	 40 000 227 437
J9	Non-controlling interests (P/L) Non-controlling interests (OCI) Non-controlling interests (SCE) Recognition of NCI's portion of profit and exchange differences on translation for the current year	70 800 160 600 	 231 400
J10	Other income: Dividend received (P/L) Non-controlling interests (SCE) Dividend paid (SCE) (LSL250 000 × R0,70 (closing spot)) Elimination of intragroup dividend	140 000 35 000 	 175 000
J11	Suspense account: Proceeds on disposal (SFP) Foreign currency translation reserve (SCE) (analysis) Changes in ownership (SCE) (balancing) Non-controlling interests (SCE) (analysis) Change in ownership interest on disposal of 20% to separate equity category	250 000 160 600 160 800 	 571 400

	Comments	
	a	The amount for the change in ownership recognised in equity can be calculated as follows (see IFRS 10.B96) (from the perspective of the NCI) :
		Fair value of the consideration paid by NCI 250 000
		Amount by which the non-controlling interests are adjusted (reserves acquired from parent) (571 400)
		NCI after transaction (analysis) 1 127 800
		NCI before transaction (analysis) (556 400)
		(321 400)
		Add: FCTR already treated as equity 160 600
		Amount to be recognised directly in equity (R160 800)
	b	Alternatively, the amount for the change in ownership recognised in equity can also be calculated as follows (from the change in the parent's interest) :
		Fair value of the consideration received by the parent 250 000
		Equity relinquished to NCI (571 400)
		Historic fair value of shares disposed of (375 000)
		Attributable post-acquisition equity disposed of:
		Retained earnings (35 800)
		FCTR (160 600)
		(321 400)
		Add: FCTR already treated as equity 160 600
		Amount to be recognised directly in equity (R160 800)

Calculations

C1 Analysis of owners' equity of Travel Ltd

	Total LSL	Rate	Total R	ECT (80%–60%)		NCI (20%–40%) R
				At R	Since R	
i At acquisition (1/7/20.27)						
Share capital	100 000	0,50	50 000	40 000		10 000
Retained earnings	1 254 687	0,50	627 344	501 875		125 469
Revaluation surplus	1 228 125	0,50	614 063	491 250		122 813
Remeasurement of factory building (4 million – 3,2 million)	800 000	0,50	400 000	320 000		80 000
Deferred tax (800 000 × 25%)	(200 000)	0,50	(100 000)	(80 000)		(20 000)
	3 182 812	0,50	1 591 407	1 273 125		318 282
Equity represented by goodwill – Parent and NCI	537 188	0,50	268 593	226 875		41 718
Consideration (3 000 000 × 0,5) and NCI (100 000 × 20% × 36 × 0,5)	3 720 000	0,50	1 860 000	1 500 000		360 000
ii Since acquisition						
• Current year:						
Profit (650 000 – ¹ 80 000 + ² 20 000)	590 000	0,60	354 000		283 200	70 800
Dividend paid (30/06/20.28)	(250 000)	0,70	(175 000)		(140 000)	(35 000)
Exchange differences on translation (OCI)	–	–	802 999		642 399	160 600
Equity/NAV (30/06/20.28)	4 059 998	0,70	2 841 999		785 599	556 400
30/06/20.28						
Disposal of interest				³ (375 000)	⁴ (196 400)	571 400
					589 199	1 127 800

(1) 800 000 / 10 years remaining useful life = 80 000 depreciation

(2) 200 000 / 10 years remaining useful life = 20 000 deferred tax

(3) 1 500 000 × 20/80 = 375 000

(4) (283 200 – 140 000) × 20/80 = 35 800 RE
 642 399 × 20/80 = 160 600 FCTR

196 400

C2 Goodwill remeasurement

	LSL	Rate	R
At acquisition date	537 186	R0,50	268 593
Exchange differences on translation: 20.28			107 437
30/06/20.28	537 186	R0,70	376 030

C3 Factory building remeasurement

	LSL	Rate	R
At acquisition date	800 000	R0,50	400 0000
Exchange differences on translation: 20.28			160 000
30/06/20.28	800 000	R0,70	560 0000

C4 Deferred tax remeasurement

	LSL	Rate	R
At acquisition date	(200 000)	R0,50	(100 000)
Exchange differences on translation: 20.28			(40 000)
30/06/20.28	(200 000)	R0,70	(140 0000)

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Consolidated statement of cash flows

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STATEMENT OF CASH FLOWS – IAS 7

Definitions Cash Cash on hand and demand deposits. Cash equivalents Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Operating activities Principal revenue-producing activities of the entity and other activities that are not investing or financing activities. Investing activities Acquisition and disposal of long-term assets and other investments not included in cash equivalents. Financing activities Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.	Accounting treatment Operating activities +/- Investing activities +/- Financing activities = Movement in cash and cash equivalents Use: ☐ Direct method Receipts from customers less payments to suppliers and employees. ☐ Indirect method Profit or loss adjusted for non-cash items, investment income, finance costs and movements in debtors, creditors and inventory.
Operating activities Principal revenue-producing activities; generally result from the transactions and other events that enter into the determination of profit or loss. Examples: ☐ Sale of goods and rendering of services; ☐ Royalties, fees, commissions and other revenue; ☐ Payments to suppliers for goods and services; ☐ Payments to and on behalf of employees; ☐ Income taxes; ☐ Receipts and payments from contracts held for dealing or trading purposes; ☐ Interest received/paid and dividends received/paid disclosed separately.	Financing activities Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. Examples: ☐ Issuing or redemption of shares or other equity instruments; ☐ Proceeds from issuing debentures, loans, notes, bonds, mortgages and other short- or long-term borrowings; ☐ Repayments of amounts borrowed; ☐ Payments by a lessee for the reduction of the outstanding liability relating to a lease.
Investing activities Acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples: ☐ Acquisition or sale of property, plant and equipment, intangibles and other long-term assets; ☐ Acquisition or sale of financial assets that are not held for trading; ☐ Loans granted and repayment of loans.	

Introduction

16.1 Background

- 1 The contents and format of the consolidated statement of cash flows are essentially identical to those of the statement of cash flows of an individual company and are prescribed by IAS 7.
- 2 The consolidated statement of cash flows comprises four elements:
 - ☐ cash flows from **operating activities**;
 - ☐ cash flows from **investing activities**;
 - ☐ cash flows from **financing activities**;
 - ☐ net movement in **cash and cash equivalents**, representing the differences between cash and cash equivalents at the beginning and end of the reporting period.



Comment

The statement of cash flows of a company in effect represents a summary (in a specific format) of the company's primary record of first entry, namely the cashbook.

Example 16.1**Consolidated statement of cash flows**

The following represents the abridged consolidated statements of the P Ltd Group for the year ended 31 December 20.26:

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.26		
	20.26	20.25
ASSETS		
Non-current assets		
Land and buildings at valuation	122 389	102 000
Plant and equipment		
Cost price	196 684	157 824
Accumulated depreciation	(71 449)	(54 100)
Goodwill	3 200	3 200
Investment in associate	12 973	7 505
Other financial assets	4 738	4 679
	268 535	221 108
Current assets		
Inventory	46 655	32 625
Receivables	68 387	60 345
Bank and money market assets	2 833	3 011
	117 875	95 981
Total assets	R386 410	R317 089
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	15 650	15 650
Retained earnings	86 971	76 708
Other components of equity	99 149	78 760
	201 770	171 118
Non-controlling interests	8 008	7 082
Total equity	209 778	178 200
Non-current liabilities		
Deferred tax	40 351	34 639
Interest-bearing loans	49 308	34 423
Total non-current liabilities	89 659	69 062
Current liabilities		
Payables	45 270	36 033
Tax due	2 388	2 712
Shareholders for dividends	6 291	6 291
Short-term loans	33 024	24 791
Total current liabilities	86 973	69 827
Total liabilities	176 632	138 889
Total equity and liabilities	R386 410	R317 089

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.26	
Revenue	140 421
Cost of sales	(62 502)
Gross profit	77 919
Other income (dividends received – R725; interest received – R2 264)	2 989
Other expenses	(39 023)
Finance costs	(9 920)
Share of profit of associate	4 745
Profit before tax	36 710
Income tax expense	(13 616)
PROFIT FOR THE YEAR	23 094
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Revaluation surplus	20 389
Other comprehensive income for the year, net of tax	20 389
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R43 483
Profit attributable to:	
Owners of the parent	21 946
Non-controlling interests	1 148
	R23 094
Total comprehensive income attributable to:	
Owners of the parent	42 335
Non-controlling interests	1 148
	R43 483

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.26						
	Share capital	Revaluation reserve	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 January 20.26	15 650	78 760	76 708	171 118	7 082	178 200
Changes in equity for 20.26						
Dividends declared	–	–	(11 683)	(11 683)	(222)	(11 905)
Total comprehensive income for the year:						
Profit for the year	–	–	21 946	21 946	1 148	23 094
Other comprehensive income	–	20 389	–	20 389	–	20 389
Balance at 31 December 20.26	R15 650	R99 149	R86 971	R201 770	R8 008	R209 778

Additional information

- 1 An analysis of the notes to the statement of profit or loss and other comprehensive income indicates that the following items were included in profit before tax:
 Depreciation on plant and equipment R18 640
 Profit on sale of plant and equipment R280
- 2 The short-term portion of long-term loans included in short-term loans was R7 704 (20.25: R14 701).
- 3 No land and buildings were purchased or sold during the current year. Plant and equipment with a cost price of R2 000 and a carrying amount of R709 was sold for R989 during the current year. It is estimated that R12 000 of the current year's purchases of property, plant and equipment were incurred to expand activities.
- 4 There were no changes in the shareholdings in subsidiaries during the year under review.
- 5 Dividends of R2 615 were received from the associate during the year.
- 6 Ignore the deferred tax implications of the revaluation of the land of the parent.

Solution 16.1

P LTD GROUP CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.26	
Cash flows from operating activities	
Cash receipts from customers (C1)	132 379
Cash paid to suppliers and employees (C2)	(87 958)
Cash generated from operations	44 421
Dividend received (725 + 2 615)	3 340
Interest received	2 264
Interest paid	(9 920)
Tax paid (C7)	(8 228)
Dividend paid (C8)	(11 905)
Net cash from operating activities	R19 972
Cash flows from investing activities	
Replacement of plant and equipment (C6)	(28 860)
Investment in other financial assets (4 738 – 4 679)	(59)
Additions to plant and equipment (C6)	(12 000)
Investment in associate (12 973 – 7 505 – (4 745 – 2 615))	(3 338)
Proceeds from sale of plant and equipment	989
Net cash used in investing activities	(R43 268)
Cash flows from financing activities	
Long-term loans raised (C3)	7 888
Short-term loans raised (C4)	15 230
Net cash from financing activities	R23 118
Net decrease in cash and cash equivalents	(178)
Cash and cash equivalents at beginning of period	3 011
Cash and cash equivalents at end of period	R2 833

Calculations

C1 Cash received from customers

Receivables	Dr	Cr
Balance at beginning of year	60 345	
Revenue	140 421	
Bank (balancing figure)		132 379
Balance at end of year		68 387
	R200 766	R200 766

or

Revenue	140 421
Increase in receivables	(8 042)
	<u>R132 379</u>

C2 Cash paid to suppliers and employees

Profit and loss account	Dr	Cr
Revenue		140 421
Depreciation	18 640	
Interest paid	9 920	
Interest received		2 264
Dividend received – other		725
Dividend received – associate		2 615
Equity accounted profit		2 130
Profit on sale of plant and equipment		280
Expenses (balancing figure)	83 165	
Profit before tax	36 710	
	R148 435	R148 435

or

Cost of sales	62 502
Other expenses (statement of profit or loss and other comprehensive income)	39 023
Depreciation	(18 640)
Profit on sale of plant and equipment	280
Expenses	<u>R83 165</u>
Expenses (calculated above)	(83 165)
Increase in inventory	(14 030)
Increase in payables	9 237
Cash paid to suppliers and employees	<u>(R87 958)</u>

C3 Long-term loans raised

Long-term loans	Dr	Cr
Balance at beginning of year (34 423 + 14 701)		49 124
Raised (balancing figure)		7 888
Balance at end of year (49 308 + 7 704)	57 012	
	R57 012	R57 012

**Comment**

The reclassification of part of long-term loans as short-term loans does not represent cash flow.

C4 Short-term loans raised

Short-term loans	Dr	Cr
Balance at beginning of year (24 791 – 14 701)		10 090
Raised (balancing figure)		15 230
Balance at end of year (33 024 – 7 704)	25 320	
	R25 320	R25 320

C5 Land and buildings

Land and buildings	Dr	Cr
Balance at beginning of year	102 000	
Revaluation (99 149 – 78 760)	20 389	
Balance at end of year		122 389
	R122 389	R122 389

C6 Plant and equipment

Plant and equipment: Cost	Dr	Cr
Balance at beginning of year	157 824	
Plant and equipment sold		2 000
Purchases – expansion	12 000	
Purchases – replacement (balancing figure)	28 860	
Balance at end of year		196 684
	R198 684	R198 684

Plant and equipment: Accumulated depreciation	Dr	Cr
Balance at beginning of year		54 100
Sold	1 291	
Depreciation	71 449	18 640
Balance at end of year	R72 740	R72 740

C7 Taxation

Taxation payable	Dr	Cr
Balance at beginning of year		2 712
Statement of profit or loss and other comprehensive income (13 616 – 5 712(deferred tax))		7 904
Bank (balancing figure)	8 228	
Balance at end of year	2 388	
	R10 616	R10 616

Deferred tax	Dr	Cr
Balance at beginning of year		34 639
Statement of profit or loss and other comprehensive income (balancing figure)		5 712
Balance at end of year	40 351	
	R40 351	R40 351

C8 Dividends paid

Shareholders for dividends	Dr	Cr
Balance at beginning of year		6 291
Dividends declared		11 905
Bank (balancing figure)	11 905	
Balance at end of year	6 291	
	R18 196	R18 196



Comment

Dividends paid by a subsidiary only have an influence on a group's cash flows insofar as the portion attributable to non-controlling shareholders is concerned. The dividends declared and paid by the parent, as well as the non-controlling shareholder's portion of the subsidiaries dividend, are shown in the consolidated statement of changes in equity. As far as dividends declared by subsidiaries are concerned, only the portion due to the non-controlling shareholders is included in the consolidated statement of financial position as part of current liabilities. The cash effect of the dividend paid is disclosed in the statement of cash flows.

Associates and joint ventures

16.2 Investments in associates and joint ventures

Where an associate is equity accounted in the consolidated financial statements of the group, any profits received in cash by the investor will be reflected as dividends received in the statement of cash flows either as an investing or operating activity (as dividends received). Because the accumulated equity profits of the associate in the consolidated statement of comprehensive income do not represent a flow of cash, they are excluded from the consolidated statement of cash flows. Advances made to or by the associate during the financial year will be reflected in the statement of cash flows and classified as investing activities.

Example 16.2**Investment in associate**

P Ltd acquired an investment in an associate, A Ltd, on 31 December 20.25. P Ltd granted a loan to A Ltd on 1 July 20.26. A Ltd made repayments of R17 000 on the loan. Extracts from the consolidated financial statements of P Ltd reflect the following at 31 December 20.26:

STATEMENT OF FINANCIAL POSITION

	20.26 R	20.25 R
Investment in associate – at carrying amount	38 850	18 000
Loan to associate	18 000	–

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	20.26 R	20.25 R
Share of profit of associate	22 650	–

The only cash flows in respect of the investment in A Ltd will be the dividends received.

Investment in associate

	R		R
Opening balance	18 000	Dividend received (balancing)	1 800
Share of profit of associate	22 650	Closing balance	38 850
	<u>40 650</u>		<u>40 650</u>

Loan to associate

	R		R
Opening balance	–	Repayments (given)	17 000
Loan advanced	35 000	Closing balance	18 000
	<u>35 000</u>		<u>35 000</u>

The information will be presented as follows in the consolidated cash flow statement:

**CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED
31 DECEMBER 20.26**

	R
Cash flows from operating activities	
Dividends received	1 800
Cash flows from investing activities	
Repayment of loan by associate	17 000
Advances to associate	(35 000)

16.3 Acquisition and disposal of associates and joint ventures

Acquisitions

An investment made during the year in an associate or joint venture should be disclosed as cash flow from an investing activity. An additional investment in an existing associate or joint venture (provided that there is no change in status, e.g. the associate does not become a subsidiary) will also be disclosed as an investing activity.

Disposals

If the total investment in an associate or joint venture is disposed of, the proceeds should be presented as an investing activity. Since the total proceeds are reflected as an investing activity, the gain/loss on the disposal recognised in profit or loss should be eliminated from operating activities for cash flow purposes.

If a portion of the investment is sold and the retained investment remains an associate or joint venture, the total proceeds are reflected as an investing activity and the gain or loss should be eliminated from operating activities.

If a portion of the investment is sold and significant influence or joint control is lost, the total proceeds are reflected as an investing activity. Both the gain or loss on disposal and the fair value adjustment on the retained investment should be eliminated from operating activities for cash flow purposes.

Example 16.3	Acquisition and disposal of an associate
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P Ltd acquired a 40% interest in A Ltd on 1 January 20.26 for R193 500. Extracts from the consolidated financial statements of P Ltd reflect the following at 31 December 20.26:

STATEMENT OF FINANCIAL POSITION	
	20.26 R
Investment in associate – at carrying amount	225 000

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	
	20.26 R
Share of profit of associate	45 000

The cash flows in respect of the investment in A Ltd will be the dividends received and amounts paid for the acquisition of the associate.

Investment in associate			
	R		R
Acquisition of associate	193 500	Dividend received (balancing)	13 500
Share of profit of associate	45 000	Closing balance	225 000
	238 500		238 500

The information will be presented as follows in the consolidated cash flow statement:

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.26	
	R
Cash flows from operating activities	
Dividends received	13 500
Cash flows from investing activities	
Investment in associate	(193 500)

Assume that P Ltd sold the total investment on 31 December 20.26 for R250 000.

The information will be presented as follows in the consolidated cash flow statement:

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.26	
	R
Cash flows from operating activities	
Cash paid to suppliers and employees (+R25 000(profit) (250 000 – 225 000))	(XXX)
Dividends received	13 500
Cash flows from investing activities	
Disposal of associate	250 000
Investment in associate	(193 500)

Assume that P Ltd sold 50% of the investment on 31 December 20.26 for R107 500.

Significant influence was lost and the retained investment was classified as at fair value through other comprehensive income. The fair value adjustment (loss) on the retained investment amounted to R2 000.

The information will be presented as follows in the consolidated cash flow statement:

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.26	
	R
Cash flows from operating activities	
Cash paid to suppliers and employees (–R5 000(loss) (225 000/2 – 107 000) – 2 000(fair value adjustment))	(XXX)
Dividends received	13 500
Cash flows from investing activities	
Disposal of part of associate	107 500
Investment in associate	(193 500)

Changes in ownership interests in subsidiaries

16.4 Acquisition and disposal of a subsidiary

- Where control of a subsidiary is obtained or lost, the amount of cash paid or received as a purchase or sales consideration is entered into the statement of cash flows (under **investing activities**) net of cash and cash equivalents acquired or sold. In both cases, it is incumbent upon a group to provide full disclosure during a period of each of the following:
 - ☐ the total consideration paid or received;
 - ☐ the portion of the consideration consisting of cash and cash equivalents;
 - ☐ the amount of cash or cash equivalents in the subsidiary over which control is obtained or lost; and
 - ☐ the amount of the other assets and liabilities in the subsidiary over which control is obtained or lost, summarised by each major category (IAS 7.40).
- Obtaining or losing control of a subsidiary is therefore accounted for in terms of an **owner approach**, rather than the entity approach, which forms the basis for the preparation of the consolidated annual financial statements. The inclusion of the net cash cost price of shares purchased/net cash proceeds from shares sold in the statement of cash flows implies that the following items were calculated at the date of the transaction (acquisition date/disposal date), and that they are thus excluded from the consolidated statement of cash flows:
 - ☐ the underlying assets and liabilities of the subsidiary acquired/disposed of;
 - ☐ financing provided/discontinued by the non-controlling shareholders;
 - ☐ goodwill or excess on acquisition arising from the purchase of the shares;
 - ☐ excess of fair value over the cost of the purchase of shares in a subsidiary;
 - ☐ the profit arising from the sale of shares; and
 - ☐ the carrying amount of the investment in the associate at the date of the transaction (in the case where an associate becomes a subsidiary, or a subsidiary becomes an associate).

- 3 The treatment of the cash consideration paid or received at the time of obtaining or losing control of a subsidiary is in principle a simple procedure. Consider the following summary, which expresses the purchasing by P Ltd of an 80% equity share in the subsidiary S Ltd at date of acquisition.

Net assets acquired

Land and buildings	(1 200 000)
Plant and equipment:	
Cost price	(800 000)
Accumulated depreciation	300 000
Mortgage bond	500 000
Inventory	(350 000)
Receivables	(550 000)
Payables	180 000
Bank	(30 000)
	<u>(1 950 000)</u>
Non-controlling interests	390 000
Goodwill	(40 000)
	<u>R1 600 000</u>

In the consolidated statement of cash flows the following will be included as part of "investing activities":

Net cash cost price of shares in subsidiary (1 600 000 – 30 000) R1 570 000

It should be borne in mind that the collection of R1 570 000 implies that a portion of the movement which occurred in the relevant statement of financial position items (between the two "statement of financial position" dates) has been included in the statement of cash flows. The portions of the movements that have been entered into the statement of cash flows (as a result of the inclusion of the net cash cost price) are represented by the amounts on the transaction date, as indicated in the above summary. In addition, when analysing the movements that occurred in the statement of financial position items, cognisance should be taken of assets and liabilities (on the transaction date) purchased from and sold to subsidiaries. The outline of the analysis of the movement in the statement of financial position items under land and buildings would have to be expanded as follows:

LAND AND BUILDINGS		
	Dr	Cr
Balance at beginning of year	XX	
Non-cash portion of movement		
Revaluation (the full revaluation movement for the current year, not only the parent's portion)	XX	
Mortgage bond	XX	
Portion of movement entered elsewhere in the statement of cash flows		
Interest charge (interest capitalised)	XX	
Land and buildings owned by a newly purchased subsidiary at date of acquisition (at fair value in terms of IFRS 3)	XX	
Land and buildings owned by a subsidiary sold at the date of sale of the subsidiary (at consolidated carrying amount)		XX
Portion of movement arising from the relevant calculation to be included in the statement of cash flows		
Land and buildings sold (sales by individual companies within the group)		XX
Land and buildings purchased	XX	
Balance at end of year		XX
	RXXX	RXXX

Example 16.4**Acquisition and disposal of a subsidiary**

The following represents the abridged consolidated statements of the P Ltd Group for the year ended 31 December 20.26.

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.26		
	20.26	20.25
ASSETS		
Non-current assets		
Land at cost	955 000	650 000
Plant and equipment		
Cost price	2 490 000	1 850 000
Accumulated depreciation	(630 000)	(740 000)
Goodwill	75 000	50 000
Investment in associate	1 835 000	910 000
	4 725 000	2 720 000
Current assets		
Inventory	675 000	405 000
Receivables	805 000	625 000
Bank and money market assets	2 500	75 000
	1 482 500	1 105 000
Total assets	R6 207 500	R3 825 000
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	1 050 000	600 000
Retained earnings	1 687 500	965 000
	2 737 500	1 565 000
Non-controlling interests	495 000	400 000
Total equity	3 232 500	1 965 000
Non-current liabilities		
Deferred tax	205 000	125 000
Interest-bearing loans	2 030 000	1 200 000
Total non-current liabilities	2 235 000	1 325 000
Current liabilities		
Payables	445 000	305 000
Tax due	45 000	30 000
Shareholders for dividends	250 000	200 000
Total current liabilities	740 000	535 000
Total liabilities	2 975 000	1 860 000
Total equity and liabilities	R6 207 500	R3 825 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.26	
Revenue	3 250 000
Cost of sales	(1 250 000)
Gross profit	2 000 000
Other expenses	(767 500)
Finance costs	(135 000)
Share of profit of associate	500 000
Profit before tax	1 597 500
Income tax expense	(400 000)
PROFIT FOR THE YEAR	1 197 500
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R1 197 500
Total comprehensive income attributable to:	
Owners of the parent	972 500
Non-controlling interests	225 000
	R1 197 500

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.26					
	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 January 20.26	600 000	965 000	1 565 000	400 000	1 965 000
Changes in equity for 20.26					
Issue of shares	450 000	—	450 000	—	450 000
Acquisition of interest in subsidiary	—	—	—	160 000	160 000
Sale of interest in subsidiary	—	—	—	(260 000)	(260 000)
Dividends declared	—	(250 000)	(250 000)	(30 000)	(280 000)
Total comprehensive income for the year:					
Profit for the year	—	972 500	972 500	225 000	1 197 500
Balance at 31 December 20.26	R1 050 000	R1 687 500	R2 737 500	R495 000	R3 232 500

Additional information

- 1 The following items were included in the calculation of profit before tax:
- | | |
|-------------------------------------|----------|
| Depreciation on plant and equipment | R370 000 |
| Loss on sale of plant | R30 000 |
| Exchange rate loss on foreign loan | R150 000 |
| Profit on expropriation of land | R200 000 |
- 2 Companies in the group sold plant and equipment for R50 000. Details of the plant at date of sale were as follows:
- | | |
|--------------------------|----------|
| Cost | R230 000 |
| Accumulated depreciation | R150 000 |
- The land of a subsidiary were expropriated by the local authority for R450 000.
- 3 A portion of the plant and equipment purchased during the year under review, to the value of R550 000, was used to replace the sold plant. In addition, a portion of these purchases was financed through a finance lease of R300 000. The balance of the property, plant and equipment purchased was for the expansion of operations.
- 4 Dividends of R125 000 were received from the associate during the year.
- 5 During the year under review, long-term loans amounting to R500 000 were redeemed.
- 6 P Ltd has several subsidiaries and associates. During the year under review, the equity investment in associates was increased; a subsidiary (S Ltd) was acquired, and the whole interest in subsidiary T Ltd was sold.

Acquisition of subsidiary S Ltd

On 30 June 20.26, P Ltd obtained 80% of the issued shares in S Ltd for R665 000. On this date, the abridged statement of financial position of S Ltd was as follows:

Land	225 000
Plant and equipment (fair value)	240 000
	465 000
Inventory	250 000
Receivables	495 000
Bank	15 000
	R1 225 000
Share capital (500 000 shares)	500 000
Retained earnings	300 000
Loans	200 000
Deferred tax	50 000
Payables	175 000
	R1 225 000

Disposal of subsidiary T Ltd

On 3 January 20.24, P Ltd obtained 75% of the issued shares in T Ltd for R675 000. On that date, the owners' equity of T Ltd was as follows:

Share capital (600 000 shares)	R600 000
Retained earnings	R300 000

On 30 September 20.26, P Ltd sold its entire interest in T Ltd for R850 000. Particulars of the net assets of T Ltd on 30 September 20.26 were as follows:

Land	350 000
Plant and equipment:	
Cost	450 000
Accumulated depreciation	(210 000)
Inventory	180 000
Receivables	420 000
Bank overdraft	(30 000)
Payables	(120 000)
	<u>R1 040 000</u>

Solution 16.4

P LTD GROUP CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.26		
	Note	
Cash flows from operating activities		
Cash receipts from customers		3 145 000
Cash paid to suppliers and employees		(1 852 500)
Cash generated from operations		1 292 500
Dividend Received		125 000
Interest paid		(135 000)
Tax paid (30 000 + 370 000 – 45 000)		(355 000)
Dividend paid (200 000 + 280 000 – 250 000)		(230 000)
Net cash from operating activities		R697 500
Cash flows from investing activities		
Replacement of plant and equipment		(550 000)
Additions to land		(680 000)
Additions to plant and equipment		(350 000)
Proceeds from sale of plant and equipment		50 000
Proceeds on sale of land		450 000
Purchase of subsidiary (665 000 – 15 000)	1	(650 000)
Investment in associate		(550 000)
Proceeds on sale of subsidiary (850 000 + 30 000)	2	880 000
Net cash used in investing activities		(R1 400 000)
Cash flows from financing activities		
Long-term loans repaid		(500 000)
Long-term loans raised		680 000
Proceeds from issue of shares		450 000
Net cash from financing activities		R630 000
Net decrease in cash and cash equivalents		(72 500)
Cash and cash equivalents at beginning of period		75 000
Cash and cash equivalents at end of period		<u>R2 500</u>

Notes to the statement of cash flows**1 Purchase of subsidiary S Ltd**

Fair value of assets acquired:	
Land	(225 000)
Plant	(240 000)
Inventory	(250 000)
Receivables	(495 000)
Payables	175 000
Loan	200 000
Deferred tax	50 000
Bank	(15 000)
	(800 000)
Non-controlling interests	160 000
Goodwill	(25 000)
Purchase price	(665 000)
Cash on acquisition	15 000
Net cash purchase price	(R650 000)

2 Disposal of subsidiary T Ltd

Land	350 000
Plant and equipment	240 000
Inventory	180 000
Receivables	420 000
Payables	(120 000)
Bank overdraft	(30 000)
	1 040 000
Non-controlling interests	(260 000)
Goodwill	—
Profit on sale of shares	70 000
Proceeds from sale	850 000
Bank overdraft of subsidiary sold	30 000
Net cash proceeds	R880 000

**Comment**

Note that IAS 7 does not specifically require the disclosure of the non-controlling interests and goodwill in the purchase or disposal of a subsidiary note to the statement of cash flows, but it is regarded as useful information and thus disclosed.

Calculations

C1 Net changes in receivables, inventory and payables

Inventory	Dr	Cr
Balance at beginning of year	405 000	
Subsidiary acquired	250 000	
Subsidiary disposed of		180 000
Net increase (balancing figure)	200 000	
Balance at end of year		675 000
	R855 000	R855 000

Receivables	Dr	Cr
Balance at beginning of year	625 000	
Subsidiary acquired	495 000	
Subsidiary disposed of		420 000
Net increase (balancing figure)	105 000	
Balance at end of year		805 000
	R1 225 000	R1 225 000

Payables	Dr	Cr
Balance at beginning of year		305 000
Subsidiary acquired		175 000
Subsidiary disposed of	120 000	
Net increase (balancing figure)		85 000
Balance at end of year	445 000	
	R565 000	R565 000

C2 Cash received from customers

Sales	3 250 000
Net increase in receivables	(105 000)
	R3 145 000

	Comment If sales are taken up directly in the “receivables” reconstruction, cash received from customers can be determined as the balancing figure.
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C3 Cash paid to suppliers and employees

Profit and loss account	Dr	Cr
Revenue		3 250 000
Depreciation	370 000	
Loss on sale of plant	30 000	
Exchange rate loss	150 000	
Interest paid	135 000	
Investment income		125 000
Equity income of associate		375 000
Profit on sale of land		200 000
Profit on sale of subsidiary		70 000
Expenses (balancing figure)	1 737 500	
Profit before tax	1 597 500	
	R4 020 000	R4 020 000

Or	
Cost of sales (statement of profit or loss and other comprehensive income)	1 250 000
Other expenses (statement of profit or loss and other comprehensive income)	767 500
Depreciation	(370 000)
Exchange rate loss	(150 000)
Profit on sale of subsidiary (850 000 – (1 040 000 × 75%))	70 000
Profit on sale of land	200 000
Loss on sale of plant	(30 000)
Expenses	R1 737 500
Expenses (Calculated above)	(1 737 500)
Net increase in inventory	(200 000)
Net increase in payables	85 000
	(R1 852 500)

C4 Taxation

Deferred tax	Dr	Cr
Balance at beginning of year		125 000
Subsidiary acquired		50 000
Tax expense (balancing figure)		30 000
Balance at end of year	205 000	
	R205 000	R205 000

Tax payable	Dr	Cr
Balance at beginning of year		30 000
Statement of profit or loss and other comprehensive income (400 000 – 30 000)		370 000
Bank (balancing figure)	355 000	
Balance at end of year	45 000	
	R400 000	R400 000

C5 Plant and equipment purchased

Plant and equipment: Cost	Dr	Cr
Balance at beginning of year	1 850 000	
Subsidiary acquired (fair value)	240 000	
Subsidiary disposed of		450 000
Plant sold by individual companies in the group		230 000
Finance lease	300 000	
Cash purchases (balancing figure)	900 000	
Balance at end of year		2 610 000
	R3 290 000	R3 290 000

Plant and equipment: Accumulated depreciation	Dr	Cr
Balance at beginning of year		740 000
Subsidiary disposed of	210 000	
Plant sold by individual companies in the group	150 000	
Depreciation expense		370 000
Balance at end of year	750 000	
	R1 110 000	R1 110 000

C6 Land purchased

Land	Dr	Cr
Balance at beginning of year	650 000	
Subsidiary acquired	225 000	
Subsidiary disposed of		350 000
Land and buildings sold by individual companies in the group (450 000 – 200 000)		250 000
Cash purchases (balancing figure)	680 000	
Balance at end of year		955 000
	R1 555 000	R1 555 000

C7 Long-term loans raised

Long-term loans	Dr	Cr
Balance at beginning of year		1 200 000
Subsidiary acquired		200 000
Loans repaid	500 000	
Exchange rate loss		150 000
Plant (finance lease)		300 000
Loans raised (balancing figure)		680 000
Balance at end of year	2 030 000	
	R2 530 000	R2 530 000

C8 Dividends paid

Shareholders for dividends	Dr	Cr
Balance at beginning of year		200 000
Dividends declared		280 000
Bank (balancing figure)	230 000	
Balance at end of year	250 000	
	R480 000	R480 000

C9 Investment in associate

Investment in associate	Dr	Cr
Balance at beginning of year	910 000	
Share of profit of associate	500 000	
Dividend received		125 000
Bank (balancing figure)	550 000	
Balance at end of year		1 835 000
	R1 835 000	R1 835 000

16.5 Acquisition of a subsidiary in terms of a non-cash transaction

- 1 No cash flow takes place when the purchase price of a subsidiary is fully settled by the issue of shares in the parent. Consequently, the acquisition of the subsidiary and the issue of the shares, respectively, are not reported as part of **investing activities** or **financing activities**. However, should cash and cash equivalents be held by a subsidiary at date of acquisition under the particular circumstances, they would be reported as follows as an investing activity:

Cash and cash equivalents held by a subsidiary at date of acquisition RXXX

- 2 In the event of a subsidiary being acquired in terms of a non-cash transaction, details regarding the subsidiary's assets, liabilities and other relevant information should once again be provided by way of a note. Should the subsidiary be acquired partly for cash and partly for the issue of shares in the parent, only the net cash portion of the purchase price is entered as an investing activity. The note on assets, liabilities and other relevant information should, however, still be provided.

16.6 An associate becomes a subsidiary and a subsidiary becomes an associate

- 1 The acquisition of an additional equity interest in an associate during the current year that causes the associate to become a subsidiary will:
- ☐ cause the acquirer to remeasure its previously held equity interest in the associate at its acquisition date fair value and recognise the difference in profit or loss (IFRS 3.42);
 - ☐ eliminate the carrying amount of the investment in the associate at the acquisition date; and
 - ☐ cause the net asset (assets and liabilities valued in terms of IFRS3) of the subsidiary at date of acquisition, including any accruals since the date of acquisition, to be entered in the consolidated statement of financial position.

- 2 The fair value adjustment included in profit or loss does not represent cash flow.
- 3 The net cash cost price of the additional equity interest in the subsidiary is entered into the statement of cash flows as part of “investing activities”. Details of the assets, liabilities, carrying amount of the investment in the former associate, as well as other relevant information, are provided in a note to the statement of cash flows.
- 4 In bringing into account the net cash cost price, part of the movements that occurred in the individual statement of financial position items between the two “statement of financial position” dates has been entered into the statement of cash flows. The portion of the movements that has already been entered represents the portion attributable to the individual assets, liabilities and non-controlling owners’ equity of the subsidiary at date of acquisition.
- 5 The disposal of an equity interest in a subsidiary during the current year that causes the subsidiary to become an associate will:
 - ☐ at the date of the transaction, create an investment against the carrying amount in an associate;
 - ☐ cause the remeasurement of the carrying amount of the abovementioned investment at the acquisition date fair value, and recognition of the difference in profit or loss; and
 - ☐ cause the net assets (assets and liabilities measured at the consolidated carrying amount) of the subsidiary at date of the transaction to be excluded from the consolidated statement of financial position.
- 6 The fair value adjustment included in profit or loss does not represent cash flow.
- 7 The net cash proceeds from the equity interest disposed of are entered into the statement of cash flows as part of “investing activities”. Details of the assets, liabilities, non-controlling owners’ equity, profit/loss on the sale of an interest and the carrying amount of the resulting investment in the associate are provided in a note to the statement of cash flows.
- 8 A portion of the movements that occurred in the individual statement of financial position items between the two “statement of financial position” dates was entered into the statement of cash flows when the net cash proceeds were accounted for. The portion of the movements already entered represents the portion attributable to the individual assets, liabilities and owners’ equity of the subsidiary on the transaction date.

Example 16.5**Associate becomes a subsidiary and a subsidiary becomes an associate**

The following represent the abridged consolidated statements of the P Ltd Group for the year ended 31 December 20.26.

P LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.26		
	20.26	20.25
ASSETS		
Non-current assets		
Property at valuation	1 008 000	650 000
Plant and equipment		
Cost price	2 490 000	1 850 000
Accumulated depreciation	(630 000)	(740 000)
Goodwill	97 500	55 000
Investment in associate	400 000	275 000
Investment in unlisted shares	840 000	840 000
	4 202 500	2 930 000
Current assets		
Inventory	675 000	405 000
Receivables	805 000	625 000
Bank and money market assets	15 000	75 000
	1 495 000	1 105 000
Total assets	R5 700 500	R4 035 000
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	1 050 000	600 000
Retained earnings	1 052 500	477 000
Other components of equity	240 000	–
	2 342 500	1 077 000
Non-controlling interests	520 000	400 000
Total equity	2 862 500	1 477 000
Non-current liabilities		
Deferred tax	258 000	125 000
Interest-bearing loans	1 840 000	1 898 000
Total non-current liabilities	2 098 000	2 023 000
Current liabilities		
Payables	445 000	305 000
Tax due	45 000	30 000
Shareholders for dividends	250 000	200 000
Total current liabilities	740 000	535 000
Total liabilities	2 838 000	2 558 000
Total equity and liabilities	R5 700 500	R4 035 000

P LTD GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.26	
Revenue	3 250 000
Cost of sales	(1 250 000)
Gross profit	2 000 000
Other income (dividend received on listed investments)	60 000
Other expenses	(719 500)
Interest paid	(135 000)
Share of profit of associate	210 000
Profit before tax	1 415 500
Income tax expense	(400 000)
PROFIT FOR THE YEAR	1 015 500
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Revaluation surplus	300 000
Other comprehensive income, net of tax	300 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	R1 315 500
Profit attributable to:	
Owners of the parent	825 500
Non-controlling interests	190 000
	R1 015 500
Total comprehensive income attributable to:	
Owners of the parent	1 065 500
Non-controlling interests	250 000
	R1 315 500

P LTD GROUP CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.26						
	Share capital	Re-valuation reserve	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 January 20.26	600 000	–	477 000	1 077 000	400 000	1 477 000
Changes in equity for 20.26						
Issue of shares	450 000	–	–	450 000	–	450 000
Associate becomes a subsidiary	–	–	–	–	160 000	160 000
Subsidiary becomes an associate	–	–	–	–	(260 000)	(260 000)
Dividends declared	–	–	(250 000)	(250 000)	(30 000)	(280 000)
Total comprehensive income for the year:						
Profit for the year	–	–	825 500	825 500	190 000	1 015 500
Other comprehensive income	–	240 000	–	240 000	60 000	300 000
Balance at 31 December 20.26	R1 050 000	R240 000	R1 052 500	R2 342 500	R520 000	R2 862 500

Additional information

- 1 The following items were, amongst others, included in other expenses:

Expenses

Depreciation R370 000

Impairment of goodwill R12 500

Income

Profit on sale of plant R30 000

Exchange rate loss on foreign loan R50 000

Profit on sale of property R200 000

Profit on sale of shares in subsidiary R67 000

Fair value adjustments on carrying amounts of investments in associates after changes in shareholdings R51 000

(R35 000 (S Ltd) + R16 000 (A Ltd))

- 2 Companies in the group sold plant and equipment for R110 000. Details of the plant at date of sale were as follows:

Cost R350 000

Accumulated depreciation R270 000

Certain land and buildings of a subsidiary were sold for an amount of R450 000, whilst another subsidiary, in which P Ltd has an 80% equity interest, revalued its land and buildings at an amount of R353 000. Attributable deferred tax is R53 000.

- 3 A portion of the plant and equipment purchased during the year under review, to the value of R580 000, was used to replace the sold plant. The balance of the property, plant and equipment purchased was for the expansion of operations. R20 000 is still due in respect of these purchases, which amount has been included under payables.
- 4 During the year under review, long-term loans amounting to R500 000 were redeemed.
- 5 P Ltd has interests in several subsidiaries and an associate. During the year under review, the following changes in interest took place:
 - ☐ An associate (S Ltd) became a subsidiary due to the purchase of an additional interest in equity for R345 000. The fair value of the 40% interest previously held amounted to R355 000 at the date of the change in the shareholding. Assume that all net assets values were equal to the IFRS 3 values.
 - ☐ A subsidiary (A Ltd) became an associate due to the sale of an interest in equity for R538 000. The fair value of the remaining 30% interest held amounted to R330 000 at the date of the change in the shareholding.
 - ☐ P Ltd elected to measure the non-controlling interests at their proportionate share of the acquiree's identifiable net assets at the acquisition date.
- 6 The following equity analyses were applied inter alia in the preparation of the given consolidated financial statements:

(a) Analysis of owners' equity of S Ltd

	Total	P Ltd 40%–80%		NCI
		At	Since	
i At acquisition (1/1/20.23)				
Share capital	500 000	200 000		300 000
Retained earnings	80 000	32 000		48 000
	580 000	232 000		348 000
Investment in S Ltd		R232 000		
ii Since acquisition				
• To beginning of current year:				
Retained earnings	120 000		48 000	72 000
• Current year:				
Profit 1/1/20.26–30/6/20.26	100 000		40 000	60 000
	800 000		88 000	480 000
Purchase 200 000 shares		320 000		(320 000)
				160 000
Cost price of shares		(345 000)		
Profit 1/7/20.26–31/12/20.26	150 000		120 000	30 000
	R950 000		R208 000	R190 000

P Ltd received dividends amounting to R95 000 from S Ltd while S Ltd was an associate.

(b) Analysis of owners' equity of A Ltd

	Total	P Ltd 75%–30%		NCI
		At	Since	
i At acquisition (1/1/20.23)				
Share capital	200 000	150 000		50 000
Retained earnings	100 000	75 000		25 000
	300 000	225 000		75 000
Equity represented by goodwill		5 000		
Consideration and NCI		R230 000		
ii Since acquisition				
• To beginning of current year: Retained earnings	600 000		450 000	150 000
• Current year: Profit 1/1/20.26–31/3/20.26	140 000		105 000	35 000
	1 040 000		555 000	R260 000
Sold 90 000 shares		(135 000)	(333 000)	R468 000
Profit 1/4/20.26–31/12/20.26	250 000		75 000	
	R1 290 000		R297 000	

- 8 Details of the net assets of S Ltd and A Ltd on the respective dates of the changes in interest are as follows:

	S Ltd 30/6/20.26	A Ltd 31/3/20.26
Land and buildings	225 000	350 000
Plant and equipment:		
Cost	240 000	450 000
Accumulated depreciation		(210 000)
Long-term loans	(200 000)	
Deferred tax	(50 000)	
Inventory	250 000	180 000
Receivables	495 000	420 000
Bank	15 000	(30 000)
Payables	(175 000)	(120 000)
	R800 000	R1 040 000

Solution 16.5

P LTD GROUP CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.26		
	Note	
Cash flows from operating activities		
Cash receipts from customers		3 145 000
Cash paid to suppliers and employees		(2 020 000)
Cash generated from operations		1 125 000
Dividends received (60 000 + 95 000)		155 000
Interest paid		(135 000)
Tax paid (30 000 + (400 000 – 30 000(C4)) – 45 000)		(355 000)
Dividend paid (200 000 + 280 000 – 250 000)		(230 000)
Net cash from operating activities		R560 000
Cash flows from investing activities		
Replacement of plant and equipment		(580 000)
Additions to land and buildings		(380 000)
Additions to plant and equipment		(600 000)
Proceeds from sale of plant and equipment		110 000
Proceeds on sale of land and buildings		450 000
Purchase of subsidiary	1	(330 000)
Proceeds on sale of subsidiary	2	568 000
Net cash used in investing activities		(R762 000)
Cash flows from financing activities		
Long-term loans repaid		(500 000)
Long-term loans raised		192 000
Proceeds from issue of shares		450 000
Net cash from financing activities		R142 000
Net decrease in cash and cash equivalents		(60 000)
Cash and cash equivalents at beginning of period		75 000
Cash and cash equivalents at end of period		R15 000

Notes to the statement of cash flows**1 Purchase of subsidiary S Ltd**

Fair value of assets acquired:	
Land and buildings	(225 000)
Plant	(240 000)
Inventory	(250 000)
Receivables	(495 000)
Payables	175 000
Loan	200 000
Deferred tax	50 000
Bank	(15 000)
	<u>(800 000)</u>
Non-controlling interests	160 000
Fair value of investment previously accounted for on the equity method	355 000
Goodwill (345 000 + 160 000 + 355 000 – 800 000)	(60 000)
	<u>(345 000)</u>
Purchase price	(345 000)
Cash on acquisition	15 000
	<u>(R330 000)</u>

2 Disposal of subsidiary A Ltd

Land and buildings	350 000
Plant and equipment	240 000
Inventory	180 000
Receivables	420 000
Payables	(120 000)
Bank overdraft	(30 000)
	<u>1 040 000</u>
Non-controlling interests	(260 000)
Goodwill realised	5 000
Fair value of remaining investment	(330 000)
Fair value adjustment on carrying amount of investment in associate (330 000 – 30/75 (230 000 + 555 000))	16 000
Profit on sale of shares	67 000
	<u>538 000</u>
Proceeds from sale	538 000
Bank overdraft on sale	30 000
	<u>R568 000</u>

Calculations

C1 Net changes in receivables, inventory and payables

Inventory	Dr	Cr
Balance at beginning of year	405 000	
Subsidiary acquired	250 000	
Subsidiary disposed of		180 000
Net increase (balancing figure)	200 000	
Balance at end of year		675 000
	R855 000	R855 000

Receivables	Dr	Cr
Balance at beginning of year	625 000	
Subsidiary acquired	495 000	
Subsidiary disposed of		420 000
Net increase (balancing figure)	105 000	
Balance at end of year		805 000
	R1 225 000	R1 225 000

Payables	Dr	Cr
Balance at beginning of year		305 000
Subsidiary acquired		175 000
Subsidiary disposed of	120 000	
Property, plant and equipment acquired		20 000
Net increase (balancing figure)		65 000
Balance at end of year	445 000	
	R565 000	R565 000

C2 Cash received from customers

Revenue	3 250 000
Net increase in receivables	(105 000)
	R3 145 000

	Comment If sales are taken up directly in the “receivables” reconstruction, cash received from customers can be determined as the balancing figure.
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C3 Cash paid to suppliers and employees

Profit and loss account	Dr	Cr
Revenue		3 250 000
Depreciation of assets and impairment of goodwill	382 500	
Profit on sale of plant		30 000
Interest paid	135 000	
Exchange rate loss	50 000	
Dividend received – other		60 000
Share of profit of associate		210 000
Profit on sale of property		200 000
Profit on sale of subsidiary		67 000
Fair value adjustments on carrying amounts of investments in associates		51 000
Expenses (balancing figure)	1 885 000	
Profit before tax	1 415 500	
	R3 868 000	R3 868 000

Or

Cost of sales (statement of profit or loss and other comprehensive income)	1 250 000
	719 500
Other expenses (statement of profit or loss and other comprehensive income)	(370 000)
Depreciation	(12 500)
Impairment of goodwill	(50 000)
Exchange rate loss	30 000
Profit on sale of plant	200 000
Profit on sale of property	67 000
Profit on sale of shares in subsidiary	51 000
Fair value adjustments	1 885 000
Expenses	(1 885 000)
Expenses (Calculated above)	
Net increase in inventory	(200 000)
Net increase in payables	65 000
	(R2 020 000)

C4 Deferred tax expense

Deferred tax	Dr	Cr
Balance at beginning of year		125 000
Revaluation of land and buildings		53 000
Subsidiary acquired		50 000
Tax expense (balancing figure)		30 000
Balance at end of year	258 000	
	R258 000	R258 000

C5 Plant and equipment purchased

Plant and equipment: Cost	Dr	Cr
Balance at beginning of year	1 850 000	
Subsidiary acquired	240 000	
Subsidiary disposed of		450 000
Plant sold by individual companies in the group		350 000
Payables	20 000	
Cash purchases (balancing figure)	1 180 000	
Balance at end of year		2 490 000
	R3 290 000	R3 290 000

Plant and equipment: Accumulated depreciation	Dr	Cr
Balance at beginning of year		740 000
Subsidiary disposed of	210 000	
Plant sold by individual companies in the group	270 000	
Depreciation expense		370 000
Balance at end of year	630 000	
	R1 110 000	R1 110 000

C6 Land and buildings purchased

Land and buildings	Dr	Cr
Balance at beginning of year	650 000	
Subsidiary acquired	225 000	
Subsidiary disposed of		350 000
Land and buildings sold by individual companies in the group		250 000
Revaluation	353 000	
Cash purchases (balancing figure)	380 000	
Balance at end of year		1 008 000
	R1 608 000	R1 608 000

C7 Investment in associate

Investment in associate	Dr	Cr
Balance at beginning of year	275 000	
Share of profit of associate	210 000	
Dividend received		95 000
Fair value adjustment	35 000	
Investment in S Ltd derecognised		355 000
Investment in A Ltd recognised	330 000	
Balance at end of year		400 000
	R850 000	R850 000

C8 Long-term loans raised

Long-term loans	Dr	Cr
Balance at beginning of year		1 898 000
Subsidiary acquired		200 000
Loans repaid	500 000	
Exchange rate loss		50 000
Loans raised (balancing figure)		192 000
Balance at end of year	1 840 000	
	R2 340 000	R2 340 000

16.7 Financing activities between non-controlling shareholders and the group

- Loans from non-controlling shareholders and proceeds from shares issued by a subsidiary to non-controlling shareholders are entered separately in the consolidated statement of cash flows as part of financing activities.
- A share issue to non-controlling shareholders results in a reduction (dilution) of the parent's interest in the subsidiary. The inclusion in the consolidated statement of cash flows of the proceeds from the shares issued to non-controlling shareholders implies that the following items were brought into account on the date of issue and should therefore be excluded from the consolidated statement of cash flows:
 - ☐ the increase in the non-controlling interests (comprising shares and the reserves transferred to non-controlling shareholders); and
 - ☐ the change in ownership accounted for as an equity transaction.
- Notwithstanding the change in ownership accounted for as an equity transaction, the issue of shares by a subsidiary to non-controlling shareholders only affects the movements in one statement of financial position item, namely "non-controlling interest".

16.8 Acquisition and disposal of an interest in an existing subsidiary that does not result in a loss of control

- This paragraph deals with the following two cases in particular
 - ☐ the increase in an interest in an existing subsidiary arising from the acquisition of an additional equity interest for cash; and
 - ☐ the decrease in an interest in a subsidiary (the investee remains a subsidiary) arising from the disposal of an equity interest for cash.
- The expenditure relating to the investment or the proceeds from the sale of the investment is shown separately as part of **financing activities**. The inclusion of the cash cost price/proceeds in respect of the abovementioned changes in interest implies that the following items were brought into account at date of the transaction and that they should therefore be excluded from the consolidated statement of cash flows:
 - ☐ the change in the non-controlling interests; and
 - ☐ the change in ownership accounted for as an equity transaction.

- 3 Notwithstanding the possible change in ownership accounted for as an equity transaction, the acquisition of an interest in an existing subsidiary, as well as the disposal of an interest in a subsidiary (to the extent that the investee remains a subsidiary), only affects the movement in non-controlling shareholders.

Sundry aspects

16.9 Foreign operations

- 1 The translation of the financial statements of foreign operations gives rise to exchange rate conversion differences. The question of whether the exchange rate conversion differences and the changes which occur in the amounts of the assets and liabilities represent cash flow solely because the exchange rates have changed now arises.
- 2 Exchange differences arising from these translations are recognised in other comprehensive income. The parent's attributable portion thereof is included in a reserve known as the foreign currency translation reserve. The portion attributable to non-controlling shareholders is included in equity as part of the non-controlling interests.
- 3 In preparing the statement of cash flows, the exchange differences arising from currency translations allocated to the foreign currency translation reserve and non-controlling interests are reversed. A corresponding adjustment is made to a non-current asset and/or current liability. In example 16.6, the full amount is taken into account (when analysing the changes that occurred) in "land and buildings".

16.10 Changes in Liabilities

- 1 Entities are required to disclose changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash flow changes.
- 2 The following should be disclosed in relation to the changes in liabilities:
 - ☐ the change from financing cash flows
 - ☐ the change in obtaining and losing control
 - ☐ the change in foreign exchange rates; and
 - ☐ the change in fair values.
- 3 This requirement also applies to changes in financial assets disclosed as part of the financing activities of the entity.
- 4 This can be done through the preparation of a reconciliation for the liabilities.

16.11 Discontinued operations

- 1 IFRS 5.33 (c) requires that the net cash flows of discontinued operations attributable to operating, investing and financing activities shall be disclosed. These disclosures may be presented either in the notes or in the financial statements. In example 16.6 in this work, the disclosure is presented in the notes.

16.12 Intragroup loans

- 1 Loans made by a parent to a subsidiary during the normal course of business have no effect on the group's cash and cash equivalents. Such intragroup loans are, in any event, eliminated during the preparation of the consolidated statement of financial position.
- 2 However, an existing shareholders' loan is often taken over on the acquisition of a subsidiary. In such a case, an outflow of cash takes place in respect of both the shares and the loan purchased. The purchasing of the shares and the loan are shown as part of "investing activities". Details of the loan assumed are also provided in the note to the statement of cash flows that deals with the acquisition of the subsidiary. When a loan is sold upon disposal of a subsidiary, the resulting cash inflow is shown as part of "investing activities".

Example 16.6**Sundry aspects**

The following information relates to the Rain Ltd Group for the year ended 31 December 20.25:

RAIN LTD GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.25		
	20.25	20.24
ASSETS		
Non-current assets		
Land at valuation	1 941 413	1 632 300
Plant and equipment at cost less accumulated depreciation	2 667 100	2 143 500
Investments in associates	345 000	335 000
Investment in Snow Ltd at fair value	—	190 000
Goodwill	52 000	52 000
	5 005 513	4 352 800
Current assets		
Inventory	960 800	957 200
Trade receivables	1 055 900	1 040 200
Cash and cash equivalents	64 700	66 510
Non-current assets held for sale	72 000	—
	2 153 400	2 063 910
Total assets	R7 158 913	R6 416 710
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital (2 200 000 shares; 2 000 000 shares)	2 307 500	2 000 000
Foreign currency translation reserve	—	36 000
Mark-to-market reserve	—	65 082
Revaluation surplus	115 000	50 000
Retained earnings	1 856 750	992 518
	4 279 250	3 143 600
Non-controlling interests	343 325	23 210
Total equity	4 622 575	3 166 810
Non-current liabilities		
Long-term loan	—	700 000
Deferred tax	59 538	44 200
Total non-current liabilities	59 538	744 200
Current liabilities		
Trade payables	2 438 700	2 444 000
Shareholders for dividends	4 200	5 000
Tax payable	33 900	56 700
Total current liabilities	2 476 800	2 505 700
Total liabilities	2 536 338	3 249 900
Total equity and liabilities	R7 158 913	R6 416 710

RAIN LTD GROUP EXTRACT OF CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.25	
Revenue	4 500 200
Cost of sales	(1 925 000)
Gross profit	2 575 200
Other expenses	(874 400)
Finance costs	(250 600)
Share of profit of associates	14 000
Profit before tax	1 464 200
Income tax expense	(435 800)
PROFIT FOR THE YEAR	R1 028 400
Profit attributable to:	
Owners of the parent	840 400
Non-controlling interests	188 000
	R1 028 400

The following additional information has already been taken into account in the financial statements above.

- Included in other expenses in the consolidated profit before tax of the Rain Ltd Group are the following:

Depreciation on plant and equipment	R480 000
Unrealised exchange gain on foreign debtors	R(127 000)
Realised exchange loss on long-term loan	R115 000

Other expenses are furthermore shown net of any other income, reclassification adjustments and/or profit that may be forthcoming from the additional information which follows.
- Investment in Snow Ltd

Rain Ltd acquired 100 000 shares in Snow Ltd on 2 January 20.24 for a cash amount of R110 000 when the equity of Snow Ltd was as follows:

Share capital (1 000 000 shares)	R1 000 000
Retained earnings	R100 000

Rain Ltd purchased another 500 000 shares in Snow Ltd for a cash amount of R1 225 000 on 1 January 20.25. On this date, Rain Ltd obtained control over Snow Ltd. The fair value of the plant and equipment (the only asset/liability of Snow Ltd) was R2 500 000 on that date. There are no tax consequences for the plant and equipment.
- Investment in Hail Ltd

Rain Ltd acquired a 60% interest in Hail Ltd on 1 January 20.24. On this date, Rain Ltd obtained control over Hail Ltd. Hail Ltd is incorporated in Go-Go land and has a functional currency of FC. No goodwill arose at acquisition date.

Rain Ltd sold its entire interest in Hail Ltd on 1 October 20.25 for R1 366 920. On this date, Rain Ltd lost control over Hail Ltd. The exchange rate was FC1 = R17,28 on 1 October 20.25.

Particulars of the net assets of Hail Ltd at 1 October 20.25 were as follows:

Plant and equipment	105 000
Trade receivables	52 500
Bank overdraft	(30 000)
	<u>FC127 500</u>

An amount of R7 980 regarding the foreign exchange rate gain in the current year on this investment has been allocated to the non-controlling interests. It may be assumed that the movement in the foreign currency translation reserve (FCTR) is attributable to plant and equipment only.

Hail Ltd was the only foreign operation of Rain Ltd.

- 4 The minutes of the directors' meeting of Rain Ltd, held on 1 January 20.25, confirm that the management decision to discontinue the operations of the packaging department of Rain Ltd was ratified with effect from 1 January 20.25. The decision was announced on this date. The packaging department specialises in the distribution of packaging and has always been a material division of Rain Ltd. The division was separately identifiable for physical, operational and financial reporting purposes.

The operations of the packaging department were discontinued on 31 August 20.25. The enforcement of the formal plan to end operations had a material influence on the packaging department for the period 1 January 20.25 to 31 August 20.25. An extract of the financial statements, prepared by management for the packaging department, for the eight months ending 31 August 20.25 was as follows:

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 AUGUST 20.25	
Revenue	483 000
Cost of sales	(246 000)
Gross profit	237 000
Other expenses	(654 000)
Loss before tax	(417 000)
Taxation relief – current	166 500
LOSS AFTER TAX	(R250 500)

STATEMENT OF FINANCIAL POSITION ITEMS AS AT 31 AUGUST 20.25		
	31/8/20.25	31/12/20.24
Inventory	–	R370 500
Trade receivables	–	R579 000
Trade payables	–	(R393 000)

The above statement of profit or loss and other comprehensive income figures of the packaging department are included in the applicable profit or loss categories in the statement of profit or loss and other comprehensive income of Rain Ltd. All losses incurred by the packaging department are deductible for tax purposes.

- 5 Finance costs incurred on qualifying equipment amounted to R286 000 during the 20.25 financial year. This interest was incurred on a loan that was acquired specifically for the acquisition and installation of the equipment, which took a substantial time to complete. Half of the finance costs incurred is still outstanding and is included in trade payables at 31 December 20.25. The equipment was installed and ready for use as intended by management on 31 December 20.25. Interest earned on the temporary investment of borrowed funds amounted to R146 900 for the year and is included in other expenses.
- 6 Rain Ltd classified plant, with a carrying amount of R78 000, as held for sale on 31 December 20.25. This was the only asset classified as such by the group. No plant or equipment was disposed of during the year.
- 7 The only companies in the group that own land are Rain Ltd and Ice Ltd, a subsidiary in which Rain Ltd has an 80% interest. Both these companies revalued their land during the 20.25 financial year. The land of Ice Ltd increased in value with R90 000 during 20.25. Neither party disposed of any land during the year.
- 8 Rain Ltd declared a dividend of R41 250 for the year ended 31 December 20.25.
- 9 It may be assumed that no impairment relating to goodwill has taken place.
- 10 Apart from movements that are clearly evident from the information above, no disposals or acquisitions of investments took place during the year.
- 11 Rain Ltd elected to measure non-controlling interests for all acquisitions at the proportionate share of the net asset value.
- 12 Cash flows from dividends and interest paid and received are classified as operating activities.
- 13 Rain Ltd irrevocably elected to present any subsequent changes in the fair value of their equity instruments in other comprehensive income in terms of **IFRS 9 Financial Instruments**.
- 14 Assume a tax rate of 27% and a capital gains tax inclusion rate of 80%. Ignore the effects of value-added tax (VAT) and dividends tax.

Solution 16.6

RAIN LTD GROUP CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20.25			
	Continuing	Discontin- ued	Total
Cash flows from operating activities			
Cash receipts from customers (C1)	2 642 300	1 062 000	3 704 300
Cash payments to suppliers and employees (C2)	(1 879 670)	(922 500)	(2 802 170)
Cash generated by operations	762 630	139 500	902 130
Interest paid (C3)	(246 700)		(246 700)
Dividends paid (C9)	(50 747)		(50 747)
Income taxes paid (C5)	(631 558)	166 500	(465 058)
Dividends received (C10)	4 000		4 000
Interest received (given)	146 900		146 900
Net cash from operating activities	(R15 475)	R306 000	R290 525
Cash flows from investing activities			
Acquisition of property, plant and equipment (208 205 [C6] + 236 950 [C7])			(445 155)
Acquisition of subsidiary (given)			(1 225 000)
Proceeds on disposal of subsidiary * (1 366 920 + (30 000 x R17,28))			1 885 320
Net cash from investing activities			R215 165
Cash flows from financing activities			
Proceeds from issue of share capital (2 307 500 – 2 000 000)			307 500
Loan repaid (700 000 + 115 000)			(815 000)
Net cash used in financing activities			(R507 500)
Net decrease in cash and cash equivalents			(1 810)
Cash and cash equivalents at beginning of period			66 510
Cash and cash equivalents at end of period			R64 700

Calculations**C1 Cash receipts from customers**

Continuing

Trade receivables – opening balance (1 040 200 – 579 000)	461 200
– closing balance (given)	(1 055 900)
Foreign exchange gain (given)	127 000
Revenue (4 500 200 – 483 000)	4 017 200
Disposal of subsidiary (52 500 × R17,28)	(907 200)
	<u>2 642 300</u>

Discontinued

Trade receivables – opening balance (given)	579 000
Revenue (given)	483 000
	<u>R1 062 000</u>

C2 Cash paid to suppliers and employees

Continuing

Cost of sales (1 925 000 – 246 000)	(1 679 000)
Other expenses (874 400 + 146 900 – 654 000)	(367 300)
Non-cash items:	
Depreciation (non-cash) (given)	480 000
Exchange gain on debtors (non-cash) (given)	(127 000)
Exchange loss on long-term loan (financing activity) (given)	115 000
Gain on bargain purchase [1 225 000 + 190 000 – (60% × 2 500 000)]	(85 000)
Impairment loss on held for sale asset (non-cash) (78 000 – 72 000)	6 000
Profit on disposal of subsidiary [1 366 920 – (60% × 127 500 × 17,28)]	(45 000)
Reclassification adjustment of FCTR [36 000 + (7 980 / 40% × 60%)]	(47 970)
Movements in working capital:	
Inventory [960 800 – (957 200 – 370 500)]	(374 100)
Trade payables – opening balance (2 444 000 – 393 000)	(2 051 000)
– closing balance (2 438 700 – 143 000)	
(50% of outstanding finance cost)	2 295 700
	<u>(R1 879 670)</u>

Discontinued

Cost of sales (given)	(246 000)
Other expenses (given)	(654 000)
Movements in working capital:	
Inventory – opening balance (given)	370 500
Trade payables – opening balance (given)	(393 000)
	<u>(R922 500)</u>

C3 Interest paid

Finance costs (given)	(250 600)
Borrowing costs capitalised to plant and equipment	
(286 000 – 146 900)	(139 100)
Finance costs unpaid at year-end (286 000 × 50%) (given)	143 000
	<u>(R246 700)</u>

C4 Revaluation surplus of Rain Ltd

Revaluation surplus – opening balance (given)	50 000
– closing balance (given)	(115 000)
Revaluation by Ice Ltd	
$[(90\,000 \times 80\%) - (90\,000 \times 80\% \times 80\% \text{ (CGT rate)} \times 27\%)]$	56 448
Post-tax revaluation of Rain Ltd	<u>(R8 552)</u>

C5 Income taxes paid

Deferred tax – opening balance (given)	(44 200)
– closing balance (given)	59 538
Revaluation by Ice Ltd $(90\,000 \times 80\% \times 27\%)$	(19 440)
Revaluation by Rain Ltd $[8\,552 \text{ [C4]} / (1 - (80\% \times 27\%)) \times 80\% \times 27\%]$	(2 356)
Deferred tax movement included in income tax expense in P/L	(6 458)
Continued operations tax expense $(435\,800 + 166\,500)$	<u>(602 300)</u>
Current tax for the year	(608 758)
Tax payable – opening balance (given)	(56 700)
– closing balance (given)	33 900
	<u>(R631 558)</u>

C6 Land – additions

Land – opening balance (given)	1 632 300
– closing balance (given)	(1 941 413)
Revaluation by Ice Ltd (given)	90 000
Revaluation by Rain Ltd $[8\,552 \text{ [C4]} / (1 - (80\% \times 27\%))]$	10 908
	<u>(R208 205)</u>

C7 Plant and equipment – additions

Plant and equipment – opening balance (given)	2 143 500
– closing balance (given)	(2 667 100)
Increase in FCTR $(7\,980 / 0,4)$	19 950
Subsidiary acquired (given)	2 500 000
Subsidiary sold $(105\,000 \times R17,28)$	(1 814 400)
Depreciation (given)	(480 000)
Borrowing costs capitalised (C3)	139 100
Plant classified as held for sale (given)	(78 000)
	<u>(R236 950)</u>

C8 Dividends declared by subsidiaries to NCI

NCI – opening balance (given)	(23 210)
– closing balance (given)	343 325
Profit for the year (given)	(188 000)
FCTR attributable to NCI (given)	(7 980)
Revaluation $[(90\,000 \times 20\%) - (90\,000 \times 20\% \times 80\% \times 27\%)]$	(14 112)
Subsidiary acquired $(2\,500\,000 \times 40\%)$	(1 000 000)
Subsidiary sold $(127\,500 \times R17,28 \times 40\%)$	881 280
	<u>(R8 697)</u>

C9 Dividends paid

Shareholders for dividends	– opening balance (given)	(5 000)
	– closing balance (given)	4 200
Rain Ltd (given)		(41 250)
NCI (C8)		(8 697)
		<u>(R50 747)</u>

C10 Dividends received

Investments in associates	– opening balance (given)	335 000
	– closing balance (given)	(345 000)
Share of profit of associates (given)		14 000
		<u>R4 000</u>

Self-assessment question

Question 16.1

The following information relates to Ronda Ltd, a company with several subsidiaries and associates:

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.27		
	20.27	20.26
ASSETS		
Non-current assets		
Property, plant and equipment	4 440 500	5 750 000
Goodwill	103 000	137 000
Investments in associates	600 000	210 000
	5 143 500	6 097 000
Current assets		
Receivables	483 000	465 000
Inventories	520 000	680 000
Bank	1 886 000	183 500
	2 889 000	1 328 500
Total assets	R8 032 500	R7 425 500
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	3 600 000	2 550 000
Retained earnings	2 127 500	1 476 000
	5 727 500	4 026 000
Non-controlling interests	1 135 500	2 521 000
Total equity	6 863 000	6 547 000
Non-current liabilities		
Interest bearing borrowings	400 500	150 000
Deferred tax	391 000	463 000
Total non-current liabilities	791 500	613 000
Current liabilities		
Trade payables and accumulated interest	275 000	150 000
Short-term portion of interest bearing borrowings	60 000	50 500
South African Revenue Service	43 000	65 000
Total current liabilities	378 000	265 500
Total liabilities	1 169 500	878 500
Total equity and liabilities	R8 032 500	R7 425 500

EXTRACT FROM THE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.27	
Revenue	3 120 000
Cost of sales	(1 184 000)
Gross profit	1 936 000
Net operating costs	(732 000)
Finance costs paid	(24 000)
Dividends received	12 000
Share of profit in associate	27 000
Profit before tax	1 219 000
Income tax expense	(348 000)
PROFIT FOR THE YEAR	R871 000
Profit attributable to:	
Owners of the parent	771 500
Non-controlling interests	99 500
	R871 000

Additional information

- On 1 March 20.27, Ronda Ltd increased its 70% interest in Matador Ltd to 90%, at a total cost of R1 000 000. The purchase price was settled partly by issuing 100 000 R1 shares for R700 000. The remainder was paid in cash. At the date of acquisition of the interest, the net assets of Matador Ltd were as follows:

Property, plant and equipment	5 250 000
Receivables	380 000
Interest-bearing borrowings	(430 000)
Trade and other payables	(180 000)
Bank overdraft	(20 000)
	<u>R5 000 000</u>
- Ronda Ltd purchased a 60% interest in Ring Ltd on 1 July 20.25 for R300 000. On that date, the carrying values of the net identifiable assets approximated their fair values and the balance sheet of Ring Ltd indicated the following equity:

Share capital (250 000 shares)	250 000
Retained earnings	200 000
	<u>R450 000</u>

On 1 January 20.27, a third of this interest was sold for R160 000. On this date, control over Ring was lost and Ronda exercised significant influence over Ring. On 1 January 20.27, the fair value of the remaining investment in Ring Ltd was R320 000 and the carrying amounts of the assets of Ring Ltd were as follows:

Property, plant and equipment	1 300 000
Receivables	300 000
Inventories	150 000
Bank	40 000
Interest bearing borrowings	(685 000)
Deferred tax	(260 000)
Trade and other payables	(170 000)
	<u>R675 000</u>

The recoverable amount of goodwill was R27 000 on 30 June 20.26 and R25 500 on 1 January 20.27.

- 3 On 1 July 20.26, Ronda Ltd entered into a lease agreement. Ronda Ltd did not elect the simplified accounting treatment for the equipment. In terms of the agreement, equipment with a cost of R55 000 was leased for a period of five years. The rate implicit in the lease is 10% per annum and instalments are payable annually in arrears on 1 July.
- 4 The following are, inter alia, included in profit before taxation:

Depreciation	R355 000
Foreign exchange gain	24 000
Realised exchange loss on interest bearing foreign loan	80 000
Unrealised exchange loss on interest bearing foreign loan	70 000
Increase in the expected credit loss	22 000
Impairment of goodwill	8 500
- 5 No dividends were received from the associate.
- 6 Accept a tax rate of 27%. Ignore capital gains tax and VAT.

Required

Prepare the statement of cash flows of the Ronda Ltd Group for the year ended 30 June 20.27 according to the direct method. No notes are required.

Suggested solution 16.1

RONDA LTD GROUP
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 20.27

Cash flows from operating activities	
Cash receipts from customers (C1)	2 780 000
Cash paid to suppliers and employees (C3)	(1 154 500)
Cash generated from operations	1 625 500
Financing cost paid (24 000 – 5 500)	(18 500)
Dividends received	12 000
Dividends paid (C5)	(335 000)
Tax paid (C6)	(182 000)
	R1 102 000
Cash flows from investment activities	
Additions of property, plant and equipment (C7)	(290 500)
Purchase of interest in associate (C4)	(43 000)
Proceeds from disposal of interest in subsidiary (160 000 – 40 000)	120 000
	(R213 500)
Cash flows from financing activities	
Proceeds from long-term borrowings (C8)	740 000
Proceeds from issue of share capital by parent (C9)	350 000
Acquire additional interest in subsidiary [1 000 000 – (100 000 × 7)]	(300 000)
	R790 000
Net increase in cash and cash equivalents	1 678 500
Exchange rate profit on cash and cash equivalents (C3)	24 000
Cash and cash equivalents beginning of year	183 500
Cash and cash equivalents end of year	R1 886 000

Calculations**C1 Cash receipts from clients**

Sales	3 120 000
Movement on receivables	(340 000)
Opening balance	465 000
Ring Ltd	(300 000)
ECL movement	(22 000)
Closing balance	(483 000)
	R2 780 000

C2 Owners' equity of Ring Ltd

	Total	(60%–40%)		NCI
		At	Since	
At acquisition	450 000	270 000		180 000
Investment		300 000		
Goodwill	225 000	30 000		135 000
Since			(45 000)	
Interest disposed of (1/3)			(90 000)	
Goodwill				30 000
Impairment 20.26				(3 000)
Impairment until 1 January 20.27				(1 500)
				25 500
Realised (25 500 × 1/3)				(8 500)
				R17 000
Profit on disposal of interest				
Proceeds				160 000
Equity sold				(135 000)
Goodwill realised				(8 500)
				R16 500
Profit on remeasurement				
Fair value (given)				320 000
Carrying amounts (300 000 – (3 000 + 1 500) + 135 000 × 2/3)				(287 000)
				R33 000

C3 Cash paid to suppliers and employees

Cost of sales	(1 184 000)
Operating cost	(732 000)
Movement on inventories	10 000
Opening balance	680 000
Ring Ltd	(150 000)
Closing balance	(520 000)
Movement on payables	289 500
Opening balance	(150 000)
Ring Ltd	170 000
Accumulated interest (55 000 × 10%)	(5 500)
Closing balance	275 000
Non-cash items	406 000
Depreciation	355 000
Goodwill	8 500
ECL	22 000
Unrealised exchange rate losses	70 000
Remeasurement profit (C2)	(33 000)
Profit on disposal of interest (C2)	(16 500)
Reclassification	
Realised exchange rate loss	80 000
Exchange rate profit	(24 000)
	(R1 154 500)

C4 Investment in associate

Investment in associate opening balance	210 000
Share of profit of associate	27 000
Ring Ltd	320 000
Closing balance	(600 000)
	R43 000

C5 Dividends paid

Non-controlling interests opening balance	2 521 000
Interest in profit for year	99 500
Matador Ltd (20% × 5 000 000)	(1 000 000)
Ring Ltd (180 000 + 90 000) (C2)	(270 000)
Closing balance	(1 135 500)
Dividend to non-controlling shareholders	215 000
Dividend paid by Ronda Ltd (2 127 500 – (1 476 000 + 771 500))	120 000
	R335 000

C6 Tax paid

Deferred tax opening balance	463 000
Ring Ltd	(260 000)
Deferred tax closing balance	(391 000)
Deferred tax	(188 000)
Total tax expenses	348 000
Current tax	160 000
SARS opening balance	65 000
SARS closing balance	(43 000)
	R182 000

C7 Additions to property, plant and equipment

Opening balance	5 750 000
Ring Ltd	(1 300 000)
Right-of-use asset	55 000
Depreciation	(355 000)
Closing balance	(4 440 500)
	R290 500

C8 Loan incurred

Opening balance (150 000 + 50 500)	200 500
Lease liability	55 000
Unrealised exchange rate loss	70 000
Realised exchange rate loss	80 000
Ring Ltd	(685 000)
Closing balance (400 500 + 60 000)	(460 500)
	R740 000

C9 Proceeds on share issues

Opening balance	2 550 000
Issue in exchange for subsidiary	700 000
Closing balance	(3 600 000)
	R350 000

C10 Goodwill

Opening balance	137 000
Impairment (given)	(8 500)
Sell subsidiary Ring Ltd (C2)	(25 500)
	R103 000

17

Advanced intragroup transactions

Intragroup transactions within a group of entities

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Advanced intragroup transactions within a group of entities

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Intragroup transactions within a group of entities

17.1 Core concepts pertaining to intragroup transactions

- 1 This chapter is dedicated to the discussion of more advanced intragroup transactions. Chapter 5 of this work addressed the core principles of eliminating intragroup balances, transactions, and unrealised gains or losses. In terms of IFRS 10.B86(c), **all intragroup assets and liabilities, equity, income, expenses and cash flows** relating to transactions between entities of the group must be **eliminated** upon consolidation. This approach stems from the concept that the group (the parent and its subsidiaries) is regarded as **one reporting entity**. The principle is that one (the reporting entity) cannot enter into transactions with oneself, nor make a profit out of oneself. The elimination of intragroup balances and transactions also ensures that the individual consolidated **line items** in the consolidated financial statements are not misstated.
- 2 Paragraph 4.5 illustrated the elimination of intragroup **dividends**. Furthermore, chapter 5 illustrated various basic intragroup transactions (for example, **loans with interest, management fees**, the sale of **inventories** and **property, plant and equipment**), with the related **tax** effect of these items.
- 3 Intragroup profits on inventories and gains on property, plant and equipment, such as land, which is not subject to depreciation, are only **realised** when the assets are sold to an entity outside the group. It was also illustrated in chapter 5 that the elimination of unrealised profit in inventory (closing inventory of year 1 will be the opening inventory of year 2) in essence comprises the deferment of the recognition of the profit from one reporting period (during which it is still unrealised for the group) to the following reporting period (during which the inventory is sold outside the group, and realised).
- 4 However, a physical transfer (or sale) is unnecessary in the case of property, plant and equipment subject to depreciation. An unrealised gain on depreciable property, plant and equipment is **“realised” through the process of depreciation** or by sale to an entity outside the group (a third party) as depreciation represents the expired portion of the future economic benefits contained in the property, plant and equipment. That portion of the intragroup gain, which is accounted for in the depreciation figure of any reporting period, is effectively realised when the products or services produced by the use of depreciable assets are sold to third parties (refer to chapter 5 for more detail).
- 5 This chapter will consider the effect of **fair value measurement** (fair value model or revaluation model) of assets (sold through an intragroup transaction) on the “realisation” of any unrealised gains or losses. The relevant examples below will illustrate that the fair value measurement and the elimination of the intragroup transaction and unrealised gains or losses have the effect that there would be **no unrealised amount that needs to be deferred** to the next financial year.

Under the fair value or revaluation model, an asset would be measured at its fair value. **IFRS 13 Fair Value Measurement** defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants”. The selling price under an intragroup transaction may not necessarily equal the recognised carrying amount (fair value). Under arm’s length transactions between market participants, the selling price should generally equal the fair value. However, with intragroup transactions, one needs to remember

that the parent has control over its subsidiary, and the selling price may be manipulated/adjusted to achieve a specific objective for the group.

- 6 Similar to depreciable assets (refer to point 4 above), where an unrealised gain/loss is “realised” through the process of depreciation, the **amortised cost model** and the effective interest method (for the unwinding of the discount) will result in the “realisation” of the unrealised gain or loss over time.
- 7 It is important to note that the **classification** (the respective line items in the financial statements) of specific assets and liabilities may differ between the various group entities. For example, an intragroup lease agreement may lead to one group entity (the lessee) recognising a right-of-use asset and a lease liability, with a net investment (for a finance lease) or accrued lease (for some operating leases) in another entity (the lessor). From a group’s perspective, an intragroup lease transaction would be eliminated, and a different asset (for example, property, plant and equipment) may be recognised. The elimination of intragroup transactions also needs to correct the **classification (line items)** from the group’s perspective.
- 8 Intragroup transactions may have specific tax consequences under the Income Tax Act. Such tax consequences may depend on the taxpayer’s intention (i.e., whether the intention is capital in nature or not) or whether the companies are regarded as a “**group of companies**” (under sections 1 and 41 of the Income Tax Act) to which the so-called **corporate rules** (sections 42–47) would apply. For tax purposes, there would be a “group of companies” if at least 70% of the equity shares in the subsidiary are held jointly, together with the parent, or directly by the parent.

The detail of such specific tax consequences are outside the scope of this work, and reference should be made to the relevant section of the Income Tax Act. The examples in this work ignore the effect of the corporate rules.

17.2 Elimination of intragroup transactions, unrealised gains or losses, and non-controlling interests

- 1 Chapter 5 also considered the effect of the elimination of intragroup transactions on the **non-controlling interests in a partially-owned subsidiary**. The elimination of intragroup interest and management fees (as examples) had no effect on the non-controlling interests. **As neither the profit nor the net assets (equity) of the group are affected by such pro forma consolidation journal entries, the non-controlling interests will also not be influenced.** For example, a similar amount is debited and credited against the profit of the group (management fees paid and received) upon consolidation, and, therefore, the non-controlling interests are not influenced by the elimination.
- 2 The elimination of the amount of the unrealised intragroup profits/(losses) (for example, from the sale of inventories, equipment, etc.), where a partially-owned subsidiary is the seller, is not influenced by the existence of the non-controlling interests. The total (100%) unrealised intragroup profit is still eliminated against the respective line items (for example, as a debit against the cost of sales of the seller and a credit against the inventories of the purchasing entity). Upon consolidation, 100% of each line item should be consolidated; therefore, 100% of the transaction should be eliminated.
- 3 Still, the elimination of the unrealised intragroup profit/(loss) may lead to a decrease/(increase) in the group’s consolidated profit (equity). Generally, the **non-controlling interests** in the profit of S Ltd for the current reporting period are

calculated after the profit of S Ltd has been adjusted by the **elimination of the unrealised intragroup profit/(loss), where the subsidiary was the selling entity (the unrealised intragroup profit/(loss) relates to the subsidiary)**. From a calculation perspective, the elimination of unrealised gains/(losses) will only be included in the “Analysis of owners’ equity of S Ltd” (to calculate the non-controlling interests) if the subsidiary was the selling entity.

Advanced intragroup transactions within a group of entities

17.3 Elimination of more advanced intragroup transactions

- 1 As this chapter is dedicated to discussing and illustrating more advanced/complex intragroup transactions, the full consolidation procedures (including preparing full sets of financial statements, detailed calculations in the analysis of equity of the subsidiary, and complete pro forma consolidation journal entries) will not be illustrated. However, the focus will be placed on the pro forma consolidation journal entries to eliminate the more advanced intragroup transactions.
- 2 In the learning process, it is important to clearly show how the figures in respect of subsidiaries are taken up in the consolidated financial statements. For this purpose, a **consolidation worksheet**, to which the necessary adjustments and eliminations are posted by means of pro forma consolidation journal entries, is used in this chapter (as in the introductory chapters of Volume 1 of this work). The worksheet aids in preparing the consolidated financial statements by adding together the amounts (100%) in the trial balances/financial statements of the parent and the subsidiary on a **line-by-line** basis, after taking pro forma consolidation journal entries into account (i.e. following the **consolidation procedures** – see IFRS 10.B86). The end result of the worksheet is to determine the consolidated amounts that are taken up in the consolidated financial statements. The last column of the worksheet will reflect the amount for the relevant line item in the consolidated financial statements.

17.4 Tangible assets measured at fair value

- 1 Some IFRSs require or allow specific tangible assets to be subsequently measured at their fair values. The purpose of this work is not to discuss the accounting treatment of such items in detail but to illustrate the elimination of any unrealised gains or losses from an intragroup transaction of these items. The following items will be illustrated in the examples below:
 - ☐ the sale of an investment property (under the fair value model of **IAS 40 Investment Property**); and
 - ☐ the sale of a revalued item of land (under the revaluation model of **IAS 16 Property, Plant and Equipment**).
- 2 Assets held for sale are generally recognised at the lower of their carrying amount and their fair value less costs to sell (under **IFRS 5 Non-current Assets Held for Sale and Discontinued Operations**). From a group’s perspective, the authors believe that a group entity will typically not “hold” an asset for sale to another group entity. The asset would arguably just be sold to the other group entity without first classifying it as held for sale by applying IFRS 5. Assets held for sale are accordingly not illustrated in this work.

Example 17.1	Intragroup sale of an investment property (under the fair value model)
---------------------	---

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, P Ltd sold an investment property with a carrying amount (fair value) of R3 500 000, to S Ltd for R3 700 000. The original cost of the investment property was R3 000 000. P Ltd and S Ltd account for all investment properties under the fair value model in terms of IAS 40.

On 31 December 20.22, S Ltd remeasured the investment property to its fair value of R3 750 000.

Required:

Prepare the pro forma consolidation journal entries regarding the intragroup transaction for the year ended 31 December 20.22. Ignore any non-controlling interests.

	Comments
	a P Ltd will, in its separate financial statements, recognise the difference between the proceeds (R3 700 000) and the carrying amount (R3 500 000) of R200 000, in profit or loss (as a profit on the sale of an asset) (see IAS 40.69). b S Ltd will, in its individual financial statements, initially measure the investment property at its cost of R3 700 000 (see IAS 40.20). The fair value gain of R50 000 (R3 750 000 – R3 700 000) will be recognised in profit or loss (IAS 40.35).

Solution 17.1

C1 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Profit on the sale of an asset (P/L) Fair value gain on an investment property (P/L) Elimination of intragroup sale of investment property and correction of fair value gain on remeasurement	200 000	200 000

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolida- ted amount R
Investment properties (at fair value) (SFP)	–	3 750 000		3 750 000
Fair value gain on an investment property (P/L)	–	(50 000)	(200 000) (J1)	(250 000)
Profit on the sale of an asset (P/L)	(200 000)	–	200 000 (J1)	–

**Comments**

- a The investment property is already measured at its fair value at the year-end. Therefore, no consolidation adjustment is needed to measure it at its fair value.
- b From the group's perspective, the fair value gain on the investment property for the year should be R250 000 (R3 750 000 – R3 500 000). S Ltd only recognised a fair value gain of R50 000 (R3 750 000 – R3 700 000), which is adjusted to reflect the correct amount for the group through the consolidation adjustment.
- c The pro forma consolidation journal entry eliminates the intragroup profit on the sale of the investment property. The group's total assets and profit remain the same, and the consolidation adjustment has no tax effect. Keep in mind that the carrying amount of the investment property was not adjusted by any consolidation adjustment (i.e. a new temporary difference does not arise as neither the carrying amount nor the tax base changed).
- d Note that the fair value measurement of the asset (under the fair value model) and the elimination of the intragroup transaction and unrealised gain have the effect that there would be no unrealised amount that needs to be deferred to the next financial year. This implies that no pro forma journal would be needed in the following financial year (i.e. the balance of the consolidated retained earnings at the end of the current financial year is not adjusted).
- e Even if the subsidiary was the selling entity, it could be argued that the non-controlling interests would be unaffected by the elimination of the unrealised profit. As neither the profit nor the net assets (**total equity**) of the group are affected by the pro forma consolidation journal entries, the non-controlling interests will also not be influenced. Furthermore, the fair value measurement may be considered as having the effect of "realising" the intragroup unrealised gain, leaving the non-controlling interests unaffected.

Example 17.2	Intragroup sale of land (under the revaluation model)
---------------------	--

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, P Ltd sold an item of land (as property, plant and equipment) with a revalued carrying amount of R3 500 000, to S Ltd for R3 700 000. The original cost of the land was R3 000 000. P Ltd and S Ltd account for land under the revaluation model in terms of IAS 16. Land is revalued at the end of every three years (the next revaluation is on 31 December 20.22). The group's policy is to transfer the revaluation surplus to retained earnings when the land is derecognised.

On 31 December 20.22, S Ltd revalued the land to its fair value of R3 750 000.

The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof.

Required:

Prepare the pro forma consolidation journal entries relating to the intragroup transaction for the year ended 31 December 20.22. Ignore any non-controlling interests.

	Comments a P Ltd will, in its separate financial statements, recognise the difference between the proceeds (R3 700 000) and the carrying amount (R3 500 000) of R200 000, in profit or loss (as a profit on the sale of an asset) (see IAS 16.69, 71) on the date of the sale. P Ltd may also have transferred the balance of the revaluation surplus of R392 000 ($R500\,000 \times 78,4\%$) (as an after-tax amount, using the effective capital gains tax rate) to retained earnings within equity (IAS 16.41 and IAS 12.64) with the derecognition of the land. b S Ltd will, in its individual financial statements, initially measure the land at its cost of R3 700 000 (see IAS 16.15). The revaluation surplus of R50 000 (before tax) ($R3\,750\,000 - R3\,700\,000$) arising on 31 December 20.22 will be recognised in other comprehensive income (IAS 16.39). S Ltd will account for the deferred tax on the revaluation of the land using the effective capital gains tax rate and recognise an amount of R10 800 ($R50\,000 \times 80\% \times 27\%$) against other comprehensive income (IAS 12.51B, 61A(a)).
--	--

Solution 17.2

C1 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Profit on the sale of an asset (P/L) Revaluation surplus (OCI) Elimination of intragroup sale of land and correction of revaluation surplus	200 000	200 000
J2	Deferred tax on revaluation surplus (OCI) ($200\,000 \times 80\% \times 27\%$) Income tax expense (P/L) Related deferred tax on the elimination of intragroup sale of land and correction of revaluation surplus	43 200	43 200
J3	Retained earnings – transfer from revaluation surplus (SCE) Revaluation surplus – transfer to retained earnings (SCE) Elimination of transfer of revaluation surplus	392 000	392 000

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolidated amount R
Land (revalued to fair value) (SPF)	–	3 750 000		3 750 000
Revaluation surplus (OCI)	–	(50 000)	(200 000) (J1)	(250 000)
Deferred tax on revaluation surplus (OCI)		10 800	43 200 (J2)	54 000
Profit on the sale of an asset (P/L)	(200 000)	–	200 000 (J1)	–
Income tax expense (P/L)	43 200	–	(43 200) (J2)	–
Retained earnings – transfer from revaluation surplus (SCE)	(392 000)	–	392 000 (J3)	–
Revaluation surplus – transfer to retained earnings (SCE)	392 000	–	(392 000) (J3)	–

**Comments**

- a The land is already at its revalued amount (fair value) at year-end. Therefore, no consolidation adjustment is needed to revalue it to its fair value.
- b From the group's perspective, the revaluation surplus on the land for the current year should be R250 000 (R3 750 000 – R3 500 000 opening carrying amount). S Ltd only recognised a revaluation increase of R50 000 (R3 750 000 – R3 700 000) (before tax) and R39 200 (R50 000 × 78,4%, after tax), which is adjusted to reflect the correct amount for the group of R196 000 (R250 000 × 78,4%; or R250 000 – R54 000) through the consolidation adjustments.
- c From the group's perspective, the cumulative balance of the revaluation surplus on the land (before tax) should be R750 000 (R3 750 000 – R3 000 000 original cost) before tax, and R588 000 (R750 000 × 78,4%) after tax. S Ltd would have recognised a revaluation increase of R39 200 (R50 000 – R10 800) (after tax). The effect of the consolidation journals on the **balance of the revaluation surplus (in equity)** is as follows:

$$R0(P) + R50\,000 - R10\,800(S) + R200\,000(J1) - R43\,200(J2) + R392\,000(J3) = R588\,000.$$
- d The pro forma consolidation journal entry (J1) eliminates the intragroup profit on the sale of the land. The group's total assets and total comprehensive income remain the same, and the consolidation adjustment has no deferred tax effect on the statement of financial position. Keep in mind that the carrying amount of the land was not adjusted by any consolidation adjustment (i.e. a new temporary difference does not arise). However, the deferred tax implications for "profit or loss" and "other comprehensive income" should be corrected, as J1 changes the amounts recognised in "profit or loss" and "other comprehensive income".

continued

- | | |
|-------------------|---|
| <p>e</p> <p>f</p> | <p>Contrary to the previous example, these pro forma consolidation journal entries would be repeated in subsequent periods to ensure that the consolidated opening balances of retained earnings and the revaluation surplus in the statement of changes in equity are correct. This results from the revaluation of the land being recognised in other comprehensive income (and not in profit or loss) as with the previous example.</p> <p>Even if the subsidiary was the selling entity, it could be argued that the non-controlling interests would be unaffected by the elimination of the unrealised profit. As neither the total comprehensive income nor the net assets (being total equity) of the group are affected by the pro forma consolidation journal entries, the non-controlling interests will also not be influenced. Furthermore, the revaluation may be considered as having the effect of “realising” the intragroup unrealised gain (albeit the classification is adjusted from “profit or loss” to “other comprehensive income”), leaving the non-controlling interests unaffected.</p> |
|-------------------|---|

17.5 Intragroup transactions on financial instruments

- 1 Financial instruments are initially measured at their fair value (IFRS 9.5.1.1). The subsequent measurement of financial instruments depends on the classification thereof in terms of **IFRS 9 Financial Instruments**. Generally, the classification of financial assets depends on the entity’s business model for managing the financial assets and the contractual cash flow characteristics thereof. Furthermore, it is possible that each entity within a group may classify specific financial instruments differently in its own financial statements (based on its own business model), but the group should still apply uniform accounting policies in preparing the consolidated financial statements. However, this chapter does not consider differences in the classification of financial instruments following an intragroup transaction. The purpose of this work is not to consider the requirements of IFRS 9 in detail. Therefore the illustration of intragroup transactions will be limited to the following items:
 - ☐ basic debt instruments (loans receivable and payable) (refer to paragraph 5.2 in chapter 5 of Volume 1 of this work);
 - ☐ investments in equity shares measured at fair value;
 - ☐ debt instruments, classified as subsequently measured at amortised cost; and
 - ☐ debt instruments, classified as subsequently measured at fair value through other comprehensive income.
- 2 Basic **debt instruments** (for example, intragroup loans) are typically subsequently measured at **amortised cost**, and interest is recognised in accordance with the effective interest method. Chapter 5 illustrated the elimination of intragroup **loan** balances and interest in cases where the amounts in the one group entity corresponded to that recognised in the other entity. Debt instruments, such as an investment in debentures, could be sold between different group entities. In such cases, the initial measurement (at fair value) for the buying entity (on which its amortised cost will be based subsequently) may differ from the original amortised cost carrying amount (which should still be used for the group’s consolidated financial statements as the same investment is still held by the group) due to the requirement of IFRS 9 to initially measure the debt investment acquired at its fair value. This chapter ignores any loss allowances for expected credit losses, as the focus is on intragroup transactions rather than on the detail of impairments on financial assets (accordingly, the amortised cost will equal the gross carrying amount of the financial assets under IFRS 9).

- 3 Some financial instruments (for example, investments in equity shares) are measured (initially and subsequently) at their **fair value**. Generally, most fair value gains or losses are recognised in profit or loss (see IFRS 9.5.7.1). However, IFRS 9 allows entities an irrevocable election to present fair value gains or losses on an investment in equity instruments (not held for trading) in other comprehensive income (IFRS 9.5.7.5). Furthermore, debt instruments (that meet the requirements of IFRS 9.4.1.2A) will be measured at fair value through other comprehensive income (IFRS 9.5.7.10), with interest recognised in profit or loss (IFRS 9.5.7.10).

Example 17.3**Intragroup sale of an investment in equity shares (at fair value through profit or loss)**

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, P Ltd sold an investment in equity shares of an unrelated listed company, with a carrying amount (fair value) of R3 500 000, to S Ltd for R3 700 000. The original cost of the investment was R3 000 000. P Ltd and S Ltd account for such investments as subsequently measured at fair value through profit or loss. The investment is held for speculative purposes.

On 31 December 20.22, S Ltd remeasured the investment to its fair value of R3 750 000.

Required:

Prepare the pro forma consolidation journal entries regarding the intragroup transaction for the year ended 31 December 20.22. Ignore any non-controlling interests.

**Comments**

- P Ltd will, in its separate financial statements, recognise the difference between the proceeds (R3 700 000) and the carrying amount (R3 500 000) of R200 000, in profit or loss (as a profit on the sale of a financial asset) (see IFRS 9.3.2.12).
- S Ltd will, in its individual financial statements, initially measure the investment at its fair value of R3 500 000 (see IFRS 9.5.1.1). The difference between the recognised investment (R3 500 000) and the cash paid (R3 700 000) of R200 000 will be recognised as a “day 1 loss” **in profit or loss** (see IFRS 9.B5.1.2A).
- The subsequent fair value gain of R250 000 (R3 750 000 – R3 500 000) will be recognised in **profit or loss** (per the accounting policy of the group) (IFRS 9.5.7.1).
- Question 17.1 deals with an intragroup sale of an investment subsequently measured at fair value through **other comprehensive income**.

Solution 17.3**C1 Pro forma consolidation journal entries**

		Dr R	Cr R
J1	Profit on the sale of a financial asset (P/L) Day 1 loss on recognition of a financial asset (P/L) Elimination of intragroup sale of equity investment and reversal of day 1 loss on initial measurement	200 000	200 000

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolidated amount R
Investment (at fair value) (SFP)	–	3 750 000		3 750 000
Fair value gain on equity investment (P/L)	–	(250 000)		(250 000)
Day 1 loss on recognition of a financial asset (P/L)	–	200 000	(200 000) (J1)	–
Profit on the sale of a financial asset (P/L)	(200 000)	–	200 000 (J1)	–



Comments

- a The investment in equity shares is already at its fair value at year-end. Therefore, no consolidation adjustment is needed to measure it at its fair value.
- b From the group's perspective, the fair value gain on the investment for the year should be R250 000 (R3 750 000 – R3 500 000), which was already recognised as such by S Ltd, and no consolidation adjustment is needed.
- c The pro forma consolidation journal entries eliminate the intragroup profit on the sale of the investment and reverse the “day 1 loss” on the initial recognition of the financial asset (by S Ltd). The group's total assets and profit remain the same, and the consolidation adjustment has no tax effect. Keep in mind that the investment's carrying amount and tax base were not adjusted by any consolidation adjustment (i.e. a new temporary difference does not arise).
- d Note that the initial fair value measurement of the asset and the elimination of the intragroup transaction and unrealised gains or losses have the effect that there would be no unrealised amount that needs to be deferred to the next financial year. This implies that no pro forma journal entry would be needed in the following financial year (i.e. the balance of the retained earnings at the end of the current financial year is not adjusted).
- e Even if the subsidiary was the selling entity, it could be argued that the non-controlling interests would be unaffected by the elimination of the unrealised profit. As neither the profit nor the net assets (**total equity**) of the group are affected by the pro forma consolidation journal entries, the non-controlling interests will also not be influenced. Furthermore, the fair value measurement may be considered as having the effect of “realising” the intragroup unrealised gain, leaving the non-controlling interests unaffected.

Example 17.4 Intragroup sale of a debt investment at amortised cost

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.21, P Ltd invested in debentures and paid R1 013 549 (fair value) for the investment. The debentures pay an annual payment of R74 000 in arrears. The debentures have a maturity date of 31 December 20.24 and are redeemable at R1 000 000. The effective interest rate is 7% per year, and the following amortisation table (rounded) applies:

Year	Payment	Interest	Capital	Balance
				1 013 549
20.21	74 000	70 948	3 052	1 010 497
20.22	74 000	70 735	3 265	1 007 232
20.23	74 000	70 506	3 494	1 003 738
20.24	74 000	70 262	3 738	1 000 000

On 1 January 20.22, P Ltd transferred the investment in the debentures to S Ltd for R1 037 423 (fair value). Based on the fair value of R1 037 423 on this date, S Ltd calculated the effective interest rate to be 6% per year ($PV = -1\,037\,423$, $PMT = 74\,000$, $n = 3$, $FV = 1\,000\,000$), and the following amortisation table (rounded) applies:

Year	Payment	Interest	Capital	Balance
20.21				1 037 423
20.22	74 000	62 245	11 755	1 025 668
20.23	74 000	61 540	12 460	1 013 208
20.24	74 000	60 792	13 208	1 000 000

P Ltd and S Ltd account for such debt investments at amortised cost, using the effective interest method.

Required:

Prepare the pro forma consolidation journal entries relating to the intragroup transaction for the year ended 31 December 20.22. Ignore all taxes and any non-controlling interests.

**Comments**

- P Ltd will, in its separate financial statements, recognise the difference between the proceeds (R1 037 423) and the carrying amount (R1 010 497) of R26 926, in profit or loss (as a profit on the sale of a financial asset) (see IFRS 9.3.2.12).
- S Ltd will, in its individual financial statements, initially measure the investment at its fair value of R1 037 423 (see IFRS 9.5.1.1).
- From the group's perspective, the original amortisation table should still be used for the amortised cost balance and the effective interest in the consolidated financial statements. Despite the intragroup sale, the group still has the same investment in debentures.

Solution 17.4

C1 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Profit on the sale of a financial asset (P/L) (1 037 423 – 1 010 497)) Finance income (P/L) (70 735 – 62 245) Investment in debentures at amortised cost (SFP) (1 007 232 – 1 025 668) Elimination of intragroup sale of debenture investment and correction of interest income and amortised cost of debentures	26 926	8 490 18 436

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolidated amount R
Investment in debentures at amortised cost (SFP)	–	1 025 668	(18 436) (J1)	1 007 232
Finance income (P/L)	–	(62 245)	(8 490) (J1)	(70 735)
Profit on the sale of a financial asset (P/L)	(26 926)	–	26 926 (J1)	–



Comments

- The pro forma consolidation journal entry eliminates the intragroup profit on the sale of the investment. It also adjusts the amortised cost balance of the investment and the finance income to reflect the amounts as in the original amortisation table for the group.
- With an intragroup sale of a depreciable asset, the unrealised gain or loss on the sale is realised through the excess depreciation (see chapter 5 of Volume 1). With an intragroup sale of an asset under the amortised cost model, the unrealised gain or loss on the sale is realised through the adjusted finance income.
- In the following year (20.23), a consolidation adjustment of R18 436 would be made against the opening retained earnings.
- If S Ltd was the selling entity, the “profit on the sale” within profit or loss of S Ltd would be debited with the unrealised intragroup gain (with the related tax effect). Similarly, the realised portion (through the lower finance income) is credited to the “finance income” of S Ltd. This procedure would then ensure that a portion of the unrealised intragroup gain is allocated to the non-controlling interests in S Ltd, just as a portion of the realised portion is allocated to the non-controlling interests in S Ltd.

Example 17.5**Intragroup debt investment at fair value through other comprehensive income (OCI)**

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, P Ltd issued debentures to S Ltd at R1 013 549 (fair value). The debentures pay an annual payment of R74 000 in arrears. The debentures have a maturity date of 31 December 20.25 and are redeemable at R1 000 000. The effective interest rate is 7% per year, and the following amortisation table (rounded) applies:

Year	Payment	Interest	Capital	Balance
				1 013 549
20.22	74 000	70 948	3 052	1 010 497
20.23	74 000	70 735	3 265	1 007 232
20.24	74 000	70 506	3 494	1 003 738
20.25	74 000	70 262	3 738	1 000 000

P Ltd accounts for the debenture liability in its separate records at amortised cost, using the effective interest method. S Ltd accounts for the debenture investment at fair value through other comprehensive income (OCI). The fair value of the debenture investment on 31 December 20.22 is R1 020 000.

Required:

Prepare the pro forma consolidation journal entries relating to the intragroup transaction for the year ended 31 December 20.22. Ignore all taxes and any non-controlling interests.

**Comments**

- a P Ltd will, in its separate financial statements, recognise finance costs of R70 948 during 20.22. The closing balance of the debenture liability at the end of 20.22 will be R1 010 497 (under the amortised cost model – see IFRS 9.4.2.1).
- b S Ltd will, in its individual financial statements, initially measure the investment at its fair value of R1 013 549 (see IFRS 9.5.1.1) and will recognise finance income of R70 948 in profit or loss for 20.22 (IFRS 9.5.7.10). S Ltd will also recognise the difference between the fair value (R1 020 000) and the amortised cost carrying amount (R1 010 497) of R9 503 in other comprehensive income (per its business model and accounting policy) (see IFRS 9.4.1.2A and 5.7.10).

Solution 17.5

C1 Pro forma consolidation journal entries

		Dr R	Cr R
J1	Finance income (P/L) Finance costs (P/L) Elimination of intragroup interest on debentures	70 948	70 948
J2	Debenture liability (SFP) Mark-to-market reserve (fair value gains) (OCI) Investment in debentures (SFP) Elimination of intragroup debentures (liability and investment) and unrealised fair value gains	1 010 497 9 503	1 020 000

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd	S Ltd	Consolidation adjustments	Consolida- ted amount
	R	R	R	R
Debenture liability (SFP)	(1 010 497)	–	1 010 497 (J2)	–
Finance costs (P/L)	70 948	–	(70 948) (J1)	–
Investment in debentures (at fair value) (SFP)	–	1 020 000	(1 020 000) (J2)	–
Finance income (P/L)	–	(70 948)	70 948 (J1)	–
Mark-to-market reserve (fair value gains) (OCI)	–	(9 503)	9 503 (J2)	–



Comments

- The pro forma consolidation journal entries eliminate the intragroup debt (debenture liability and investment), finance costs/income and any fair value gains in full.
- The non-controlling interests in S Ltd would be unaffected by the elimination of the intragroup interest (see chapter 5), as neither the profit nor the net assets (equity) of the group are affected by the pro forma consolidation journal entries. However, the non-controlling interests in the OCI of S Ltd would be calculated after taking the elimination of the fair value gain into account.

**Comments****Alternative classifications of the investment in debentures:**

- a It was indicated above that the classification of financial assets depends on the entity's business model for managing the financial assets and the contractual cash flow characteristics thereof.
- b Accordingly, S Ltd could have classified the investment in debentures as subsequently measured **at amortised cost**. The pro forma consolidation journal entries would then have been as follows:

	Dr R	Cr R
Finance income (P/L)	70 948	
Finance costs (P/L)		70 948
Debenture liability (SFP)	1 010 497	
Investment in debentures (SFP)		1 010 497

- c S Ltd could have classified the investment in debentures as subsequently measured **at fair value through profit or loss**. Neither IFRS 9 nor **IFRS 7 Financial Instruments: Disclosures** specify whether the effective interest and the fair value gain should be recognised separately. Suppose S Ltd **chose to account for the interest on the debentures separately from the fair value gains**. The pro forma consolidation journal entries would then have been as follows:

	Dr R	Cr R
Finance income (P/L)	70 948	
Finance costs (P/L)		70 948
Debenture liability (SFP)	1 010 497	
Fair value gains on investment (P/L)	9 503	
Investment in debentures (SFP)		1 020 000

- d S Ltd could have classified the investment in debentures as subsequently measured **at fair value through profit or loss**. Suppose S Ltd **chose to account for the interest on the debentures and the fair value gains in one account**. The pro forma consolidation journal entries would then have been as follows:

	Dr R	Cr R
Debenture liability (SFP)	1 010 497	
Finance costs (P/L)		70 948
Fair value gains on investment (P/L) (1 020 000 – 1 013 549 + 74 000)	80 451	
Investment in debentures (SFP)		1 020 000

17.6 Intragroup lease transactions

- Group entities may enter into lease agreements with each other. The **lessor** would first need to **classify** the lease as a finance or operating lease (see **IFRS 16 Leases**), as the classification would determine the accounting treatment thereof. The **lessee** is required to **capitalise all leases** (except for short-term leases or leases of a low-value asset) as right-of-use assets and recognise the obligations to make the payments (financial liabilities). An intragroup lease transaction would be eliminated from a group's perspective, and a different asset may need to be recognised. For example, the lessee (in the group) would classify a property leased to another group entity under an operating lease as an investment property in its

own financial statements. However, from a group's perspective, the property would be owner-occupied and be classified as part of property, plant and equipment in the consolidated financial statements. The elimination of intragroup transactions also needs to correct the **classification (line items)** from the group's perspective.

Example 17.6

Intragroup finance lease of a machine

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, S Ltd (as the lessor) entered into a finance lease agreement with P Ltd, whereby a machine (with a carrying amount of R130 000: cost of R175 000 and accumulated depreciation of R45 000) was leased to P Ltd. The fair value of the machine was R150 000 on this date.

In terms of the lease agreement, annual lease payments of R57 158 are payable annually in arrears on 31 December of each year. The lease term is three years. The residual value is estimated as immaterial. The remaining useful life of the machine is three years from 1 January 20.22. The interest rate implicit in the lease is 7% per annum, and the following amortisation table (rounded) applies to both entities:

Year	Payment	Interest	Capital	Balance
				150 000
20.22	57 158	10 500	46 658	103 342
20.23	57 158	7 234	49 924	53 418
20.24	57 158	3 740	53 418	0

P Ltd recognises depreciation (on the straight-line basis) on its right-of-use asset in a separate account for accumulated depreciation.

Required:

Prepare the pro forma consolidation journal entries regarding the intragroup transaction for the year ended 31 December 20.22. Ignore all taxes and any non-controlling interests.



Comments

a S Ltd will, in its individual financial statements, recognise the difference between the net investment in the lease (R150 000) and the carrying amount (R130 000) of R20 000, in profit or loss (as a profit on the sale of an asset). With a finance lease, substantially all the risks and rewards incidental to ownership of an underlying asset are transferred.

b P Ltd will, in its separate financial statements, recognise a right-of-use asset and a lease liability (IFRS 16.22).

Solution 17.6**C1 Pro forma consolidation journal entries**

		Dr R	Cr R
J1	Profit on the sale of an asset (P/L)	20 000	
	Lease liability (SFP)	103 342	
	Net investment in the lease (SFP)		103 342
	Right-of-use asset (SFP)		150 000
	Accumulated depreciation: Right-of-use asset (SFP) (150 000 × 1/3)	50 000	
	Depreciation: Right-of-use asset / Cost of Sale (P/L) (150 000/3)		50 000
	Property, plant and equipment (SFP) (at the original cost for the group)	175 000	
	Accumulated depreciation: PPE (SFP) (45 000 + 130 000/3)		88 333
	Depreciation: PPE / Cost of Sales (P/L) (130 000/3)	43 333	
	Finance income (P/L)	10 500	
	Finance costs (P/L)		10 500
	Elimination of intragroup finance lease		

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolida- ted amount R
Property, plant and equipment: Cost (SFP)	–	–	175 000	175 000
Accumulated depreciation: PPE (SFP)	–	–	(88 333)	(88 333)
Net investment in the lease (SFP)		103 342	(103 342)	–
Right-of-use asset (SFP)	150 000	–	(150 000)	–
Accumulated depreciation: Right-of-use asset (SFP)	(50 000)	–	50 000	–
Lease liability (SFP)	(103 342)	–	103 342	–
Depreciation: PPE/Cost of Sales (P/L)	–	–	43 333	43 333
Depreciation: Right-of-use asset/Cost of Sales (P/L)	50 000	–	(50 000)	–
Finance income (P/L)	–	(10 500)	10 500	–
Finance costs (P/L)	10 500	–	(10 500)	–
Profit on the sale of an asset (P/L)	–	(20 000)	20 000	–

	Comments a From the group's perspective, it still has the same machine under its control. The pro forma consolidation journal entries eliminate all aspects regarding the intragroup lease and the intragroup profit on the sale. Furthermore, the machine is reinstated at its original carrying amounts, and depreciation (on PPE) for the current financial year is recognised for the group. b Because S Ltd was the selling entity (lessor with finance lease), any non-controlling interests in the profit would be calculated after taking the elimination of the unrealised profit and the realised portion (through the reversal of the depreciation on the right-of-use asset and the recognition of depreciation on PPE again), into account (being: – 20 000 + 50 000 – 43 333). This approach is similar to that in chapter 5 (see example 17.11).
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Example 17.7	Intragroup operating lease of investment property
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P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, P Ltd (as the lessor) entered into an operating lease agreement with S Ltd, whereby a building (ignore the land component) (owned by P Ltd, with a carrying amount and fair value of R2 000 000) was leased to S Ltd. The building is used for administrative purposes. P Ltd accounts for all investment properties under the fair value model in terms of IAS 40.

In terms of the lease agreement, annual lease payments of R150 000 are payable annually in arrears on 31 December of each year. The lease term is three years. The interest rate implicit in the lease is 7% per annum, and S Ltd (lessee) prepared the following amortisation table (rounded):

Year	Payment	Interest	Capital	Balance
				393 647
20.22	150 000	27 555	122 445	271 202
20.23	150 000	18 984	131 016	140 186
20.24	150 000	9 814	140 186	0

S Ltd recognises depreciation (on the straight-line basis) on its right-of-use asset in a separate account for accumulated depreciation.

The remaining useful life of the building is twenty years from 1 January 20.22, with a residual value of R50 000. The group recognises depreciation on the straight-line basis.

The fair value of the building on 31 December 20.22 was R2 200 000.

Required:

Prepare the pro forma consolidation journal entries relating to the intragroup transaction for the year ended 31 December 20.22. Ignore all taxes and any non-controlling interests.

	Comments a P Ltd will, in its separate financial statements, recognise the operating lease income of R150 000, and the fair value gain on the investment property of R200 000 (R2 200 000 – R2 000 000) in profit or loss. b S Ltd will, in its separate financial statements, recognise a right-of-use asset and a lease liability (IFRS 16.22).
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Solution 17.7**C1 Pro forma consolidation journal entries**

		Dr R	Cr R
J1	Property, plant and equipment (SFP)	2 000 000	
	Accumulated depreciation: PPE (SFP) ((2 000 000 – 50 000) × 1/20)		97 500
	Depreciation: PPE/Admin expenses (P/L)	97 500	
	Investment property (SFP)		2 200 000
	Fair value gain on investment property (P/L)	200 000	
	Right-of-use asset (SFP)		393 647
	Accumulated depreciation: Right-of-use asset (SFP) (393 647 × 1/3)		
	Depreciation: Right-of-use asset/Admin expenses (P/L) (393 647 × 1/3)	131 216	
	Operating lease income (P/L)	150 000	
	Lease liability (SFP)	271 202	
	Finance costs (P/L)		27 555
	Elimination of intragroup operating lease and correction of classification for the group		

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolida- ted amount R
Property, plant and equipment: Cost (SFP)	–	–	2 000 000	2 000 000
Accumulated depreciation: PPE (SFP)	–	–	(97 500)	(97 500)
Investment property (SFP)	2 200 000	–	(2 200 000)	–
Right-of-use asset (SFP)	–	393 647	(393 647)	–
Accumulated depreciation: Right-of-use asset (SFP)	–	(131 216)	131 216	–
Lease liability (SFP)	–	(271 202)	271 202	–
Depreciation: PPE/Admin expenses (P/L)	–	–	97 500	97 500
Depreciation: right-of-use asset/Admin expenses (P/L)	–	131 216	(131 216)	–
Fair value gain on investment property (P/L)	(200 000)	–	200 000	–
Operating lease income (P/L)	(150 000)	–	150 000	–
Finance costs (P/L)	–	27 555	(27 555)	–



Comments

- a From the group's perspective, it still has the **same building** that the group occupies, and it is classified as an item of property, plant and equipment (IAS 16.6 and IAS 40.5,7). The fair value (R2 000 000) on 1 January 20.22 becomes the deemed cost for applying IAS 16 (IAS 40.60). Depreciation of the building is recognised subsequently.

17.7 Share trusts and treasury shares

- 1 Share trusts are often used by a company to facilitate the holding of its shares for the benefit of its employees (also referred to as employee share incentive trusts) or to facilitate some BEE arrangements. A company may typically set up a separate legal entity (the trust) to facilitate a specific transaction on its behalf. The purpose and design of such structured entities may imply that the company has “power” and “control” (as defined in IFRS 10) over such entities, especially where voting rights are not the dominant factor in assessing power. The relevant activities of the trust may be to achieve a special goal of the company, and decisions about the relevant activities may be pre-determined by the company. Refer to chapter 10 of this work for a more detailed discussion on whether a company has “**control**” over an investee. The company may control such share trusts without having any equity interest.
- 2 A company (parent) would typically issue some of its shares to the share trust, which will hold such shares for the benefit of the parent's employees. The investment in shares will be a financial asset in the individual records of the share trust.
- 3 From the group's perspective (with the group entities regarded as one reporting entity), the group will hold its own shares, representing **treasury shares**. The treasury shares shall be deducted from the equity in the consolidated statement of changes in equity (IAS 32.33). Furthermore, the amount of treasury shares held is disclosed separately, either in the statement of financial position or in the notes (see IAS 32.34 and IAS 1.79(a)(vi)). Also, the parent and the trust should provide disclosure in accordance with **IAS 24 Related Party Disclosures**, as the share trust would be a related party.

Example 17.8	Intragroup transactions with a share trust
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P Ltd is the parent of a share trust, and the end of the current reporting period is 31 December 20.22. The following intragroup transactions are relevant:

On 1 January 20.22, P Ltd established a share trust (a separate legal entity). The sole and unalterable purpose of the share trust is to hold shares of P Ltd on behalf of the employees of P Ltd. The employees are the sole beneficiaries of the share trust. P Ltd assessed whether it has control over the share trust in terms of IFRS 10 and concluded that it does have control over it.

On 1 January 20.22, P Ltd issued 100 000 of its ordinary shares to the share trust at the fair value of R100 each. The share trust elected to measure this investment in equity shares at fair value through profit or loss (in terms of IFRS 9) in its individual accounting records. On 31 December 20.22, the ordinary shares of P Ltd traded at R103 each. On 31 December 20.22, P Ltd declared and paid an ordinary dividend of R5 per share.

Required:

Prepare the pro forma consolidation journal entries relating to the intragroup transactions for the year ended 31 December 20.22. Ignore all taxes and any non-controlling interests.

	Comments a P Ltd will, in its separate financial statements, recognise the shares issued and the dividends declared within its equity (presented in the statement of changes in equity). b The share trust will, in its individual financial statements, recognise the investment in the parent's shares as a financial asset and remeasure it to the fair value at year-end of R10 300 000 (100 000 shares × R103), with the gain of R300 000 recognised in profit or loss, per its accounting policy. The share trust will also recognise the dividend income of R500 000 (100 000 shares × R5) in profit or loss.
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Solution 17.8**C1 Pro forma consolidation journal entries**

		Dr R	Cr R
J1	Share capital (SCE) (100 000 shares × R100) Fair value gains on investment (P/L) Investment in shares (SFP) (100 000 shares × R103) Elimination of intragroup treasury shares	10 000 000 300 000	10 300 000
J2	Dividend income (P/L) Dividends declared and paid (SCE) Elimination of intragroup dividends on treasury shares	500 000	500 000

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolidated amount R
Share capital (SCE)	(xx) + (10 000 000)	–	10 000 000	xx
Retained earnings (dividends paid) (SCE)	(xx) + 500 000	–	(500 000)	xx
Investment in shares (SFP)	–	10 300 000	(10 300 000)	–
Fair value gains on investment (P/L)	–	(300 000)	300 000	–
Dividend income (P/L)	–	(500 000)	500 000	–



Comments

- a From the group's perspective, it acquired its own ordinary shares, and both the investment in shares, with the related fair value gains, are eliminated. The treasury share transaction should be disclosed. Furthermore, the group paid dividends to itself, and the intragroup dividends were eliminated.
- b The non-controlling interests would be calculated after taking the elimination of the fair value gains and dividend income into account. From the group's perspective, the intragroup fair value gains and dividend income were eliminated in full – leaving no amount to be allocated to the non-controlling interests.

However, some technical experts may hold a different view, believing that the non-controlling interests are unaffected by the elimination of the fair value gains and dividend income, as the employees (as beneficiaries of the share trust) are indeed entitled to the profits of the share trust (for example, at liquidation). As such, the full amount (before any eliminations) should be allocated to the non-controlling interests (100%), as P Ltd holds no equity investment (0%) in the share trust.

Self-assessment questions

Question 17.1

P Ltd is the parent of S Ltd, and the end of the current reporting period is 31 December 20.22. The following intragroup transaction is relevant:

On 1 January 20.22, P Ltd sold an investment in equity shares of an unrelated listed company, with a carrying amount (fair value) of R3 500 000, to S Ltd for R3 700 000. The original cost of the investment was R3 000 000. P Ltd and S Ltd account for such investments as subsequently measured at fair value through **other comprehensive income** (OCI) (mark-to-market reserve). The investment is not held for speculative purposes. The group's policy is to transfer the mark-to-market reserve to retained earnings when the investment is derecognised.

On 31 December 20.22, S Ltd remeasured the investment to its fair value of R3 750 000.

The investment is regarded as of a capital nature for tax purposes. The company tax rate is 27% and CGT (capital gains tax) is calculated at 80% thereof.

Required:

Prepare the pro forma consolidation journal entries regarding the intragroup transaction for the year ended 31 December 20.22.

**Comments**

- a P Ltd will, in its separate financial statements, recognise the difference between the proceeds (R3 700 000) and the carrying amount (R3 500 000) of R200 000, in profit or loss (as a profit on the sale of a financial asset) (see IFRS 9.3.2.12). P Ltd would also have transferred the balance of the mark-to-market reserve of R392 000 ($R500\,000 \times 78,4\%$) (as an after-tax amount using the effective capital gains tax rate) to retained earnings within equity (IFRS 9.B5.7.1, B5.7.9).
- b S Ltd will, in its individual financial statements, initially measure the investment at its fair value of R3 500 000 (see IFRS 9.5.1.1). The difference between the recognised investment (R3 500 000) and the cash paid (R3 700 000) of R200 000 will be recognised as a “day 1 loss” **in profit or loss** (see IFRS 9.B5.1.2A).
- c The subsequent fair value gain of R250 000 ($R3\,750\,000 - R3\,500\,000$) will be recognised by S Ltd in **other comprehensive income** (per the accounting policy of the group) (IFRS 9.5.7.1(b), 5.7.5).

Suggested solution 17.1**C1 Pro forma consolidation journal entries**

		Dr R	Cr R
J1	Profit on the sale of a financial asset (P/L) Day 1 loss on the recognition of a financial asset (P/L) Elimination of intragroup sale of equity investment and reversal of day 1 loss on initial measurement	200 000	200 000
J2	Retained earnings – transfer from mark-to-market reserve (SCE) Mark-to-market reserve – transfer to retained earnings (SCE) Elimination of transfer of mark-to-market reserve	392 000	392 000

C2 Consolidation worksheet: P Ltd and subsidiary

(xx) = credit amounts	P Ltd R	S Ltd R	Consolidation adjustments R	Consolidated amount R
Investment (at fair value) (SFP)	–	3 750 000	–	3 750 000
Fair value gain on equity investment (mark-to-market reserve) (OCI)	–	(250 000)	–	(250 000)
Tax of OCI (OCI) (R500 000 × 80% × 27%)	–	54 000	–	54 000
Day 1 loss on recognition of a financial asset (P/L)	–	200 000	(200 000) (J1)	–
Profit on the sale of a financial asset (P/L)	(200 000)	–	200 000 (J1)	–
Retained earnings – transfer from mark-to-market reserve (SCE)	(392 000)	–	392 000 (J2)	–
Mark-to-market reserve – transfer to retained earnings (SCE)	392 000	–	(392 000) (J2)	–

	Comments a The investment in equity shares is already at its fair value at year-end. Therefore, no consolidation adjustment is needed to measure it at its fair value. b From the group's perspective, the fair value gain on the investment for the year should be R250 000 (R3 750 000 – R3 500 000), which was already recognised as such by S Ltd in OCI, and no consolidation adjustment is needed. c From the group's perspective, the cumulative balance of the mark-to-market reserve should be R750 000 (R3 750 000 – R3 000 000 original cost) before tax, and R588 000 (R750 000 × 78,4%) after tax. The effect of the consolidation journals on the balance of the mark-to-market reserve (in equity) is as follows: $R0 (P) + R250\,000 (S) - R54\,000 (S) + R392\,000 (J2) = R588\,000.$ d The pro forma consolidation journal entries eliminate the intragroup profit on the sale of the investment and reverse the “day 1 loss” on the initial recognition of the financial asset (by S Ltd). The group's total assets and profit remain the same, and the consolidation adjustment has no tax effect. Keep in mind that the carrying amount and tax base of the investment were not adjusted by any consolidation adjustment (i.e. a new temporary difference does not arise).
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continued

	e Note that the initial fair value measurement of the asset and the elimination of the intragroup transaction and unrealised gains or losses have the effect that there would be no unrealised amount that needs to be deferred to the next financial year. This implies that no pro forma journal entry would be needed in the following financial year (i.e. the balance of the retained earnings at the end of the current financial year is not adjusted). f Even if the subsidiary was the selling entity, it could be argued that the non-controlling interests would be unaffected by the elimination of the unrealised profit. As neither the profit nor the net assets of the group are affected by the pro forma consolidation journal entries, the non-controlling interests will also not be influenced. Furthermore, the fair value measurement may be considered as having the effect of "realising" the intragroup unrealised gain, leaving the non-controlling interests unaffected.
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